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Print Edition January 29th 2005

Democracy at gunpoint

For Iraqis, voting in their own government will be a fine thing. But democracy must bring security too ... More on this week's lead article

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Politics this week

Jan 27th 2005
From The Economist print edition

Always with us?

Reuters

Leaders of 40-odd countries gathered at **Auschwitz** to mark the 60th anniversary of its liberation by Soviet troops. Several survivors from the death camp attended, though, as Israel's foreign minister, Silvan Shalom, noted, Auschwitz is about to change from memory to history.

See article

Victor Yushchenko was inaugurated as president of **Ukraine**. He promptly named the fiery Yulia Timoshenko as his candidate for prime minister.

See article

Georgia's president, Mikhail Saakashvili, made an unprecedented offer of autonomy to the breakaway region of South Ossetia, though he accepted that Russian acquiescence would be needed to get the deal accepted. South Ossetian leaders instantaneously rejected it.

The **European Commission** president, José Manuel Barroso, unveiled his five-year work programme. He proposes to focus on the EU's agenda of economic reform.

A Milan judge provoked outrage by dropping terrorism charges against five **Islamic terrorist suspects**, on the ground that they were responsible only for “guerrilla” activities in a time of war.

Charles Clarke, Britain's home secretary, announced that 11 foreign **terror detainees** held without trial in Britain would be released from prison but kept under house arrest. Last month, the House of Lords, Britain's highest court, ruled that they had to be released from jail.

See article

Time to vote

Violence continued unabated in the run-up to the election in **Iraq** on January 30th, with campaigning almost non-existent in three mainly Sunni Arab provinces but with most Kurds and Shia Arabs apparently keen to vote. The Bush administration denied it was contemplating an early exit for its armed forces. Meanwhile, 31 American troops were killed in a helicopter crash, the largest loss of American life in a single incident since the war in Iraq began.

See article

A summit meeting within two weeks between **Israel's** prime minister, Ariel Sharon, and the Palestinians' newly-elected president, Mahmoud Abbas, appeared likely, with hopes rising for a ceasefire between Palestinian fighters and Israeli forces.

See article

More than 100 people were arrested in **Guinea**, after an apparent attempt to kill President Lansana Conté last week. He is ill and has no obvious successor; Guineans worry that his death might spark a civil war.

The **global birth rate** fell to a new low. The average woman in the developing world now has 3.9 babies over a lifetime, compared with 5.9 in the 1970s, according to the United Nations.

Adding it all up

The White House said it was requesting an extra $80 billion for **military operations** in Iraq and Afghanistan. Around 90% of the funds are for Iraq.

Condoleezza Rice was confirmed by the Senate as secretary of state, but not without a raucous floor debate initiated by Democrats. Meanwhile, Douglas Feith, under-secretary of defence for policy, said he would retire in the summer for personal reasons. The neoconservative is often cited as one of the main architects of the Iraq war.

Senate supporters of a constitutional ban on **gay marriage** said that they would still push the issue in the new Congress. George Bush indicated last week that he would not lobby for the federal amendment, though he still approves of the idea.

The Supreme Court rejected an appeal to restore a **Florida** law specifically designed to keep a severely brain-damaged woman, Terri Schiavo, alive on a feeding tube. Mrs Schiavo suffered brain damage in 1990; her husband argues that she has the right to die. Florida's governor, Jeb Bush, submits that the state has the authority to intervene in the case.

A federal judge delayed the **execution** in Connecticut (the first in New England since 1960) of Michael Ross, a serial killer who has indicated he wants to die. Arguments will now be heard as to whether Mr Ross is mentally capable of waiving his right to appeal.

Back to school

AFP

Schools in the Indonesian province of Aceh reopened for the first time since the **tsunami** struck a month ago. Indonesia's authorities again raised their estimate of those killed, bringing the total regional figure to 280,000.

Taiwan's president, Chen Shui-bian, appointed a new prime minister after the cabinet resigned in the wake of a poor election result last month. Frank Hsieh, mayor of Kaohsiung and a senior member of Mr Chen's Democratic Progressive Party that favours independence, called for reconciliation with China upon his appointment.

Japan released preliminary figures indicating that China (including Hong Kong) had overtaken the United States to become its biggest trading partner in 2004.

See article

More than 250 **Indian** pilgrims were killed in a stampede near a temple in the western state of Maharashtra.

AFP

The **Gates foundation**, the world's richest charity, founded by Bill Gates, pledged $750m over ten years to the Global Alliance for Vaccines and Immunisation, a Geneva-based campaign that funds childhood vaccinations in the developing world. Britain and Norway followed suit and pledged $1.8 billion and $290m respectively to the same group.

See article

Rebel action

The State Department denied that the United States had any involvement in the capture of Rodrigo Granda, a leader of **Colombia's** FARC guerrillas, abducted in Venezuela last month. But the department did call on President Hugo Chávez to take action against any Colombian rebels remaining in Venezuela. Meanwhile, at least 20 FARC rebels escaped from a prison 130km (80 miles) west of Bogotá, sparking a massive manhunt by hundreds of troops.

Dozens of small earthquakes rocked **Ecuador's** Pacific region, instilling tsunami panic in coastline communities. No injuries or major structural damage was reported.

Guyana's president, Bharrat Jagdeo, complained about the speed of international efforts to provide relief to areas hit by flooding last week. Mr Jagdeo said about half the country's 750,000 population has been affected.

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Business this week

Jan 27th 2005
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Fiat and General Motors

Fiat delayed, by at least a week, an effort to force **General Motors** to buy the remainder of its loss-making car division. Fiat says that a "put" option, signed between the two companies, is legally binding. The first possible date for implementing the option fell on January 24th. GM argues that the terms of the agreement have lapsed and is threatening court action. A settlement looks unlikely.

Deutsche Börse, a German exchange operator, published new details of its plan to buy the **London Stock Exchange**. Deutsche Börse, which has been criticised for a lack of openness by some of its shareholders, is still offering £5.30 ($10.00) a share. Neither it nor its main rival, Euronext, has yet made a formal bid.

General Electric posted an 18% rise in year-on-year profits for the fourth quarter. Meanwhile, Dealogic, a financial-data company, reported that GE had generated more revenue for investment banks (through fees for deals and mergers) than any other company in 2004.

Sistema, a Russian investment company, began selling shares worth $1.55 billion on the London Stock Exchange, Russia's biggest ever IPO (the company is also listed in Moscow).

A $1.75 billion agreement by **IBM** to sell its personal computer business to **Lenovo**, China's biggest PC maker, ran into trouble when American politicians said the deal raised security fears.

The operator of the tunnel that links Britain and France, **Eurotunnel**, said that commercial and tourist traffic using its car and coach shuttle service had fallen sharply in 2004, leading to a drop in operating revenues of 4%. Eurotunnel's chief executive, Jean-Louis Raymond, blamed cut-throat competition from budget airlines.

See article

Side effects

Eli Lilly, an American drugs company, announced a net loss of $2.4m for the three months ending December 31st compared with a $747m profit in the same period a year earlier. The loss was accounted for by a tax charge on the expected return of $8 billion in overseas earnings. Although global sales of all products were up in 2004, sales of Zyprexa, a treatment for schizophrenia, fell sharply.

Merck posted net income of $1.1 billion for the fourth quarter ending December, 21% lower than the same period in 2003. Profits were partially affected by the withdrawal of Vioxx, the company's

pain-relieving drug for arthritis.

See article

America's Food and Drug Administration approved, for the first time, a generic triple-combination drug for treating AIDS patients. The medicine, which will be made by South Africa's **Aspen Pharmacare** for sale in developing countries, is now eligible to be used in the Bush administration's grand plan to treat AIDS victims in poor countries.

The chairman of America's Federal Communications Commission, **Michael Powell**, announced that he would be stepping down from his post in March.

Google launched an online facility that allows people to search for television-programme stills. Recordings from several American broadcasters, including PBS and Fox News, have been indexed through their TV transcripts. The service will eventually expand to include video clips.

I feel like chicken tonight

An appeals court in the United States resuscitated part of an obesity lawsuit filed against **McDonald's**. Two overweight teenage girls from New York are seeking damages for the alleged hidden risk to their health from Chicken McNuggets and Big Macs. The appeals court said evidence could be collected for a possible trial. McDonald's said the case, dismissed by a lower court in 2003, is “frivolous”.

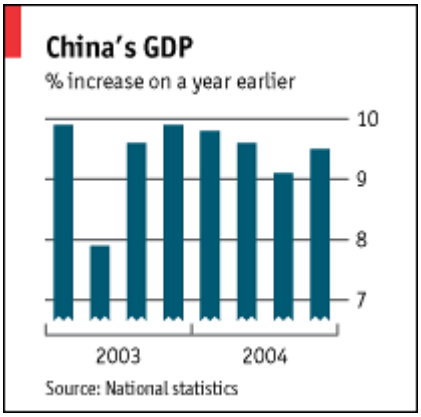
An investigation into alleged manipulation of futures contracts on the Eurex exchange by **Citigroup** traders was handed over to criminal prosecutors. The initial inquiry carried out by BaFin, Germany's financial watchdog, focuses on transactions carried out in August 2004.

Microsoft decided not to continue fighting a European Union antitrust decision that forces it to strip its media-playing software from European editions of Windows. Last month, a court upheld the decision and agreed that the automatic inclusion of Media Player curtailed competition.

Hard or soft?

China's GDP grew 9.5% in the fourth quarter of 2004 compared with the same period in 2003, according to official figures. It also increased by 9.5% for all of 2004, compared with a revised 9.3% for 2003. The Chinese government has tried to dampen rampant growth amid fears of a “hard landing” if demand drops sharply. However, there was no sign of decreased demand in the underlying statistics.

See article



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Iraq

Democracy at gunpoint

Jan 27th 2005
From The Economist print edition

For Iraqis, voting in their own government will be a fine thing. But democracy must bring security too

LOOK at it in one way and the general election due in Iraq next Sunday, January 30th, is an inspiring event. After decades of dictatorship Iraqis are being given an opportunity most Arabs can only dream about: the chance to choose their leaders in a free election. Moreover, this choice is being made possible only by the will and power of the United States, under the leadership of a president who declared on his re-inauguration last week that the survival of liberty in America "increasingly depends on the success of liberty in other lands".

Look at it another way, however, and the election is in danger of seeming a parody of democracy. Almost two years after George Bush toppled Saddam Hussein, fear and murder stalk Iraq. How free is an election in which the citizen who dares to vote stands a fair chance of being shot, blown up or beheaded for his pains? America's efforts to stabilise Iraq have so far been so ineffectual that even the location of the polling stations is having to be kept secret until the last minute. And the longer the violence continues, the hollower Mr Bush's liberty talk will sound. Two years ago, it was reasonable to hope that by helping a democracy to emerge in a post-Saddam Iraq, the United States could set an example for the rest of the Arab world to copy. At this point, many Arabs looking in horror at the chaos of Iraq are liable to draw the opposite conclusion: that it is safer to stick with the authoritarians they know.

So which is it? An inspiring experiment in liberty, or a sham that risks giving the whole idea of democracy—especially when it is imported by regime-changing Americans bearing arms—a bad name?

What Sunday can tell you, and what it can't

Only part of the answer will come on Sunday (see article). Abu Musab al-Zarqawi, al-Qaeda's self-appointed representative in Iraq, has promised to kill anyone who has the temerity to vote. He has already murdered more than enough people for Iraqis to know that this is no idle threat. On the other hand, powerful forces in Iraq—including, probably, an overwhelming majority of both Kurds and Shia Arabs—are strongly in favour of the election. If on polling day millions of people prove willing to defy the threats of the insurgents and turn out to vote, Iraq will indeed have taken a useful and inspiring stride forward. That, after all, is what happened in Afghanistan last October, in another election which Islamic fundamentalists had vowed to disrupt but which ended up by strengthening the legitimacy of the central government.

In Iraq's case, however, polling day will be only the first of many tests. It will help to show whether the majority of Iraqis want a multi-party democracy or whether, like Mr Zarqawi, they see democracy as a pernicious doctrine that puts rule by men in place of the rule of God. But showing an appetite for democracy is not the same thing as acquiring one. That entails more than just holding an election. The election must also produce a government that is capable of running the country.

Not even a high turnout on polling day is going to give Iraqis that sort of government soon. If all goes well a good turnout should produce an elected government with broader legitimacy than the present government of appointees. But because large parts of the Sunni heartland are in open revolt against the new order, and because America disbanded the old army and has been dismally slow to train a new one, the new government will still have to enforce its will at the point of an American gun. Like armed missionaries throughout history, the Americans are not popular in Iraq, even among Shias. So relying on American military power will be a hard thing for any new government to do for long without jeopardising some of the legitimacy the election confers on it.

A proper democracy does not only require effective government, freely chosen. It has also to be judged by its treatment of minorities. In Iraq, one consequence of Sunday's election is sure to be a transfer of power from the Sunni minority on which Saddam built his power to the long-oppressed Shias. The dictatorship of the majority is arguably a little less odious than the dictatorship of the minority. But only a little. If Iraq is to cohere as a single state, the Shias will have to reassure all the country's minorities that they can thrive under the new dispensation. So far, the Shia political establishment has said the right things. It promises to work with Sunnis despite the boycott of the election by some of their parties, and plays down the part religion will play in the new order. The true test will come later, when it is time to write a constitution that sets out the role of Islam, the balance between the centre and the provinces, and the sharing of oil revenues.

Timing the exit

On paper, this process is supposed to be swift. The present plan calls for the election of yet another new government under a new referendum-approved constitution by the end of this year. In practice, a country wrecked by dictatorship, invasion and insurgency will take much longer before it stands a chance of inspiring the rest of the Arab world. Until and unless legitimacy brings security and the rule of law, democracy will risk looking weak and ineffectual, not the source of hope and freedom Mr Bush desires.

As that process plays out, testing every day the mettle of democracy, the trickiest task for a new government will be to decide whether American troops are still a solution or have become a problem. They already provide a focus for nationalist insurgents, as well as daily providing new grievances by their actions. For the moment, however, the answer has to be that they should

stay, for there is no better way to fill the security vacuum that the Americans themselves created. That is certainly what the United States should want: having invaded, America and its allies have a duty to give Iraq every possible chance to make itself prosperous and free. To leave prematurely would be a shameful thing to do. But if the elected Iraqi government changes its mind, and decides that the country would be better off without them, then the Americans had better obey. After all, self-determination and freedom are what this is supposedly all about.

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The Gates foundation

Missionary zeal

Jan 27th 2005
From The Economist print edition

Yes, Bill Gates really does think he can cure the world

Science Photo Library

AIDS. Malaria. Tuberculosis. Dengue. Sleeping sickness. Bilharzia. Filariasis. The list of infectious diseases that afflict the poor world is long and depressing. The list of treatments is correspondingly short and depressing, for the incentive of those who have the money to discover and develop such treatments is slim. The end of colonialism eliminated most of the political will to do so. The lack of a market enervated the financial will. AIDS aside (and that only because it afflicts a few hundred thousand rich westerners as well as millions in poor countries), these are Cinderella diseases.

That may be a cliché, but it is oddly pertinent. For Cinderella was rescued by a fairy godmother. And although Bill Gates is more usually cast in the role of Demon King in the modern fairy tales told by computer geeks, he may yet go down in history as a fairy godfather. That is because he has given a substantial part of his fortune—some $28 billion so far—to a foundation that bears his name and that of his wife Melinda. And that foundation, the world's largest charity, is dedicated mainly to making the poor world healthier.

Fixing the wetware

The Gates foundation has been in the news this week because of a $750m grant it has made to the Global Alliance for Vaccines and Immunisation (GAVI—see article). That is big, but compared with the sums sloshing around in national foreign-aid budgets, it is not humungous. What marks it out is how well directed it is.

Although it is easy to be cynical about the motives of the rich when they turn charitable, it seems clear that Mr Gates really cares where his money goes. As Milton Friedman long ago observed, the best purchases are those made by people spending their own money. And childhood vaccination, which is what GAVI exists to promote, is a decidedly cost-effective way of saving lives, as would be the malaria and HIV vaccines that he hopes his money will help to invent. He also has a knack of shaming others into following suit. Two days after the Gates money was announced, the British government pledged almost $2 billion to vaccination.

But there may be more to it than that. One of the most intriguing facts about the foundation is that its founder is himself a scientist—or rather, and rather better, an engineer—and that as a result, he is intellectually engaged in much of the medical research he has set in motion. Mr Gates's speciality is software. Creating and selling it made him rich. Not surprisingly, he thinks he is rather good at it. And he seems to have realised what biologists themselves are only starting to come to grips with—that biology is basically a software problem in which biochemical pathways stand in for computer algorithms. From this perspective, disease is the result of software failure or inappropriate data input—a fact that is very evident when listening to a conversation between Mr Gates and his scientists about the weak points of, say, the malaria parasite.

Whatever the case, one of the most endearing features of the enterprise is that Mr Gates gives the impression that a combination of his money, his brain-power and the brain-power of the people that his money can buy could actually solve some of the problems of global health. Whether that is optimism or arrogance remains to be seen. But if he turns out to be right, the fairy godfather may trump the Demon King in the history books.

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Car industry

The quick and the dead

Jan 27th 2005
From The Economist print edition

The car industry is forming into two camps: winners and losers

LANDOV

IT WILL be an important moment in industrial history: in only a few years Toyota will topple General Motors from the number one slot among the world's carmakers, as it grows relentlessly towards 15% of the global market (see article). It makes a net profit far bigger than the combined total for Detroit's Big three; its market capitalisation towers above them; its productivity has grown sevenfold in the past 25 years, twice as much as Detroit's finest, despite their efforts to keep up.

Today Toyota leads a select band of volume car manufacturers that make real profits; the others are Nissan, Honda and Hyundai. Even when GM, Ford, the Chrysler end of DaimlerChrysler and European firms such as Renault and Volkswagen are in the black, they usually do not earn more than the cost of their invested capital. That is not to say that Detroit and the Europeans have not made great progress: manufacturing efficiency, product quality and so on are all dramatically better these days. A decade ago France, for example, had two car companies, Renault and PSA Peugeot Citroën. Both were weak. Today, Peugeot is successfully becoming more international and makes decent returns. Meanwhile, Renault has forged a unique alliance (eschewing full merger) with a resurgent Nissan to create a profitable global power.

But the worldwide market is a cruel place. There is capacity in place to produce about 80m cars and other light vehicles (pick-ups, SUVs and so on). Yet production is running at barely 60m a year, so the factories are only three-quarters full in an industry where utilisation rates need to top 80% to ensure decent profits. It is not much of a gap, but the effect on weaker carmakers is painfully evident.

Of course, much of this excess capacity is being installed in China and other parts of the Asia-Pacific region in anticipation of growth prospects that are awesome. According to a forecast by PriceWaterhouseCoopers, the region will account for almost half the increase in world car output (over 18%) that is forecast by 2011. But too much of excess capacity lies in North America and Europe, where too many producers are producing too many cars and selling them at too little profit. Detroit keeps its factories at full tilt only by offering huge discounts and other sales incentives to “move the metal”, as they say there. Hence the profitless prosperity offered by strong car sales in recent years. The same is increasingly true in Europe.

Simple, steady, realistic

So what do the winners do right to succeed in this tough game, and where are the losers going wrong? Start with the losers. Their principal and common failing is a refusal to recognise reality. If you add up the optimistic sales projections of many American and European manufacturers you get ludicrous growth projections. Either they have a crazy view of the market or unrealistic hopes of quickly winning market share from rivals. Companies such as Fiat stagger from one crisis to another, hoping for a couple of big hits that will lift them out of the mire. Meanwhile they fail to grapple with their real problems, in particular sluggish product development and poor financial discipline.

In most other industries such weak brethren would just go to the wall. But Mitsubishi Motors is getting a lifeline this week from its *keiretsu* kin, while the Fiat Group is still trying to sell its car business to GM or extract a hefty fee for releasing the Americans from an obligation to buy they stupidly signed five years ago. Perhaps it would be feasible for GM to buy Fiat Auto, declare it bankrupt and shrink it to a specialist rump that could make money and add a couple of snazzy brands to GM's tired portfolio. But takeovers just don't seem to work in the car industry: Ford has squandered billions on Jaguar; DaimlerBenz wrecked shareholder value in trying to digest Chrysler.

The winners, notably Japan's big three (Toyota, Nissan and Honda) do not have magic answers. They focus on patient execution of sensible, but ambitious, plans to expand their sales. They develop a steady stream of new models and make them with remarkable efficiency: there are no takeovers, no dramas or miracle cures, just relentless, grinding professionalism with, increasingly, an enticing dash of design flair to boot. And when they hit one target, they immediately set another.

In the case of Toyota, there is one extra ingredient that is somewhat mystical, if not exactly magical. There is such a strong corporate culture that every employee knows the “Toyota way” of doing things. Put it down on paper and it sounds as flaky as a typical mission statement. But Toyota preaches to the converted and it works.

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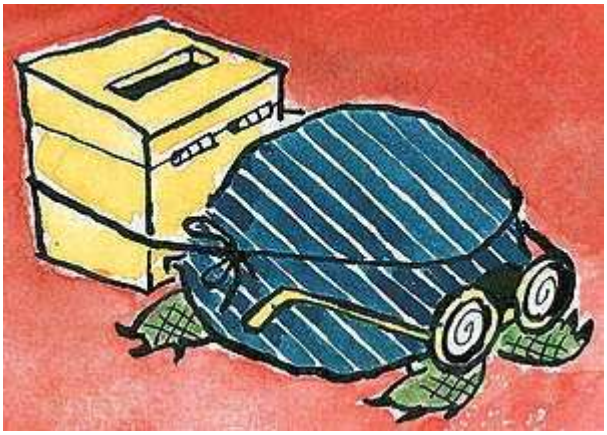
Corporate governance in Germany

No time for consensus

Jan 27th 2005
From The Economist print edition

German companies have been far too resistant to change



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SOMETHING is rotten in the state of Germany's joint-stock companies, and it is robbing them of competitiveness in a harshly competitive world. Banks, carmakers, engineering and communications companies, as well as old-fashioned conglomerates, all have struggled to keep up with rivals abroad that are set up so that they can make quicker decisions.

Is it really that bad? After all, plenty of German companies do just fine, and the problems of Germany's economy cannot all be laid at their door. Moreover, the corporate sector there seems relatively free of the gross corruption that has dogged its equivalents in America and other parts of Europe—no big scandal has made international headlines to rival America's Enron, the Netherlands' Ahold or Italy's Parmalat.

Appearances, however, are deceptive. In aggregate, Germany's companies are falling behind their competitors, and they know it. Big efforts are under way to try to understand why companies seem to be less effective at innovation than those in, say, Britain or America. As for scandals, they do happen in Germany, but the tendency when one company is embarrassed is for the others to close ranks and pretend there is no broader problem. The latest brouhaha concerns companies keeping parliamentarians on their payroll for no obvious reason but to gain political favour (see article). The main targets of scorn, however, have been not the companies, but the politicians, for failing to declare their second incomes.

As fish are said to rot from the head, so the rottenness of German companies starts with their two-board system. In addition to an executive board of directors, they all have supervisory boards, up to half the members of which represent the workforce rather than shareholders. Too

often these boards endorse decisions that merely reinforce the status quo. Appointments are far too cosy: new blood is seldom sought from outside. Most of the boards are too big to be effective, and their instinct is to defend or deny mistakes on the executive floor rather than to represent shareholders. This week, for instance, the supervisory board of Infineon, a computer-chip company, experienced little more than lively heckling at its annual meeting. That was despite a disastrous year in which the company finally (rather belatedly) fired its chief executive. No one at the supervisory level felt obliged to resign. At its recent annual meeting, ThyssenKrupp, a steel conglomerate, saw all of its old boys re-elected to the supervisory board, including a 73-year-old former chief executive and a 69-year-old who steered one of Germany's most illustrious banks close to disaster. Even Siemens, one of Germany's (and Europe's) most successful companies, has allowed its chief executive, retiring this week, to head the supervisory board.

Even if shareholders were to become more militant, there is precious little they can do to change things, despite the mock-democracy of annual shareholders' meetings. As in other countries, their protests are politely heard and then dismissed by a thundering majority of institutional voters, most of whom share the same vested interests as the managers they might otherwise tackle.

Some action please

What might change things at Germany's biggest companies? The government seems unlikely to weigh in, although it could. A voluntary corporate-governance code, published in 2003, has remained just that—voluntary. Almost one-third of the top-30 listed companies flout one of the code's main requirements: to publish specific details of how much individual bosses earn. Last year the government threatened to put this requirement into law, but it has since gone silent.

Yet there are a few simple things that can be done by the companies themselves. They could slash the size of supervisory boards; hive their real decision-making into smaller committees; and upgrade the quality and broaden the selection of board members. Better still, they could switch to the Anglo-Saxon system of a single board in which independent non-executive directors spar with executives. When set up properly, this system gets things done, and faster.

There is one truly hot potato, however, that even employers and right-wing politicians dread touching: the removal of employee representation from supervisory boards. Bizarrely, even independent economists in Germany mumble that so-called “co-determination” is a good thing and should be strengthened rather than weakened. But they forget one vital thing: companies have never been, and arguably cannot be, democracies. Today the successful ones are streamlined machines that need strong leadership amid their constant fight to survive. German companies have spent too long trying to be fair and failing to be transparent—a fatal mixture. If they are to flourish in future, they need to move on.

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Terror suspects in Britain

Practise what you preach

Jan 27th 2005
From The Economist print edition

The British government should stop punishing terror suspects without trying them

Reuters

BE CAREFUL what you wish for. After months of demanding (publicly, at least) that the Americans release the remaining four British prisoners from the Guantánamo Bay detention camp, the British government has got its way and the detainees have been sent back. So guilty were the men that the police released them immediately. The detainees' arrival compounds the embarrassment caused by the Law Lords, when they ruled last month that the indefinite detention of foreign terror suspects was illegal because it was “disproportionate” to the supposed threat and discriminated against foreigners. Sixteen have been held without trial, mainly in Belmarsh high security prison, for up to three years. Eleven remain.

Charles Clarke, the new home secretary, faces the familiar post-September 11th dilemma. Should he accept that, since the evidence against some terror suspects would not stand up or would be inadmissible in a normal court of law, they must be released? Or does terrorism pose such a danger that the criminal justice system's usual safeguards should be dispensed with? Mr Clarke's instinct is to take the latter path. His instinct is wrong.

They haven't gone away

Not that the government's desire to keep tabs on these people is frivolous. The fact that there has not been a big terrorist attack against the West since the one in Madrid last March does not mean that the threat has gone away: as Osama bin Laden's reference to the wrongs done to Muslims in 8th-century Andalucia shows, Islamist terrorists work on a longer time-scale than most people. Anyway, the absence of successful attacks does not prove any lack of terrorist effort. Mr Clarke

will have had frightening briefings from the security services about several big plots since September 11th aimed at killing Britons which, they say, have been averted.

Some of those alleged plotters are being, or are soon to be, tried. But, says the government, in some cases the evidence has been gathered in ways that makes it inadmissible in court, and in other cases, although the security services are sure that the suspects are involved in worrying activities, there is not enough evidence to make a convincing case against them, or the evidence is so sensitive that it cannot be presented in open court. That's why it has been trying to find its way around the safeguards in the criminal justice system designed to protect all defendants' rights.

Now that the Law Lords have ruled out detaining foreign suspects indefinitely without trial, the government is exploring other ways of restricting their liberty. On January 26th, the day after the Guantánamo four arrived back, Mr Clarke announced plans to keep terrorist suspects under house arrest—a power that could be used on Britons as well as foreigners—to avoid falling foul of the Lords' ruling.

Keeping suspects under house arrest without trial is better than imprisoning them in high-security jails without trial, but it is still unacceptable. Nobody should be locked up indefinitely, inside their home or out of it, when they have not faced a trial in which they have been given the opportunity to defend themselves publicly. Otherwise, any of us could be.

There are certainly weaknesses in the criminal justice system that hamper the fight against terrorism. In Britain, for instance—unlike in many rich-world countries—evidence collected by tapping people's phones is inadmissible in court. That restriction was designed to protect the security services' intelligence sources; but it is now widely believed, by both spies and policemen, to do more harm than good. Strengthening the prosecution's hand, however, is a long way from imprisoning people who have not been tried.

Tony Blair says he wants to make the world a better place. Yet in its treatment of terrorist suspects, Britain, like America, has undermined the values it purports to uphold. A little more commitment to those values at home might mean a little less scepticism about British and American motives abroad.

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Letters

Jan 27th 2005
From Economist.com

The Economist, 25 St James's Street, London SW1A 1HG
FAX: 020 7839 2968 E-MAIL: letters@economist.com

Border issues

SIR – Mexico and the United States share the most dynamic border in the world ("Dangerous desert, breached border", January 8th). Over the past two years, both governments have reached an unprecedented level of co-operation on border issues. In 2002, a border alliance was put in place in order to achieve an appropriate balance between shared security concerns and the efficient flow of goods and people. Today, there are more and better controls over what happens on the border.

As you mention, smuggler organisations pose a threat to societies on both sides. Conscious of this, the Mexican government has acted firmly to contain and eradicate this problem. During the past year alone, 120 smuggler organisations were dismantled and 1,140 criminals were apprehended. Contrary to what your unnamed sources said, Mexico and the United States have developed a successful strategy against all criminal organisations on the border and this has been publicly recognised by the United States' authorities. Border security is vitally important for both countries. The Mexican government is committed to ensuring that migration into the United States is legal, safe, orderly and respects fundamental rights.

Gerónimo Gutiérrez Fernández
Under-secretary for
North America
Mexico City

SIR – You note that "smuggling gangs could serve as a conduit for terrorists". Each month, literally hundreds of illegal immigrants are apprehended near Fort Huachuca, the United States Army's centre for intelligence training and communication-systems design. Terrorists potentially have an open gate to a facility that is key to our national defence. To us local citizens witnessing all these invaders, "homeland security" is a farce and a delusion.

Charles Eldon
Sierra Vista, Arizona

SIR – A simple way to reduce illegal migration would be to enforce existing laws against employing undocumented workers. The cost of policing would then shift from taxpayers to fines on employers. This would quickly deplete the supply of jobs and stem the flow of migrants. The current de facto policy in effect provides government subsidies in the form of tax and Social Security payment waivers to industries employing millions of illegals.

Matthias Blume

San Diego, California

How to succeed in Africa

SIR – Tony Blair has no idea of how and why Africa is the way it is ("A year of huge challenges", January 1st). The reason for Africa's sorry state lies in three core aspects: the tribal ties of the rulers, which go beyond what we would normally understand in the West; the fundamental premise of government, which is rarely democratic capitalism; and the rule of law, which is viewed differently. Success will come when the population forges its development without the shackles of tribalism (and accepts that democracy brings a stake in the welfare of their country) and when the ruling elite of each country implements the basics of democratic capitalism. Until then Africa will continue along the path it has followed for at least 350 years.

Colin Sworder
Aylesbury, Buckinghamshire

Singapore listings

SIR – You assert that the Singapore Stock Exchange "loosened its disclosure rules a few years ago" in shifting from a merit to a disclosure-based regulatory approach ("Fools rush in", December 11th). We disagree. Rules under the disclosure-based regime are not looser. In fact, Singapore has strengthened its disclosure, accounting and corporate governance standards in recent years, in line with practices in other leading financial centres. Failure by listed companies to disclose material information on a timely basis attracts criminal and civil liabilities under legislation introduced in 2002. Large listed companies must now make quarterly financial reports. All listed companies must explain deviations from the corporate governance code in their annual reports and Singapore-incorporated companies comply with accounting standards which are essentially aligned with International Accounting Standards. A new accountants act has enhanced disciplinary action against errant public accountants. However, no amount of regulation or enforcement can guarantee that companies will always comply with disclosure rules and corporate governance standards, whether in Singapore or any other financial centre.

Shane Tregillis
Monetary Authority
of Singapore
Singapore

Learning to count

SIR – The Republicans are all riled about voting problems encountered in Washington state's recent election ("Kiev by the Pacific", January 15th). Funny how they didn't seem too upset about the voting difficulties that characterised the 2000 and 2004 presidential elections.

Michael Durell
Astoria, New York

Musical legacies

SIR – Musicians and artists have a paramount interest in their recordings even when the copyright term expires in Europe after 50 years ("Not-so-golden oldies", January 8th). They create the work and give expression to the dreams, aspirations and realities of a generation, both for those listening today and those who will listen in a hundred years' time. They should be entitled to retain their copyright for at least as long as they live, and to pass it to their heirs, just like any other

asset that they own. Currently in Europe, recording artists, unlike other artists, may typically lose the rights to their creation within their lifetimes and with those rights will be lost all control over how that creation is altered, packaged and sold.

Paul McGuinness
Manager, U2
Dublin

Claiming a stake

SIR – Stakeholding does not involve government involvement in the leadership and management of enterprise which your piece on the ten-year anniversary of “The State We're In” suggested (“Face value”, January 15th). All capitalist systems operate within legal, financial and constitutional architectures. Stakeholding is simply one form of such architecture. Once constructed it is up to private agents to do as they judge appropriate within the consequent market framework.

I agree that Britain has been a major beneficiary of globalisation, but I think it is a rewriting of history to suggest that those who designed the reforms of the 1980s explicitly did so because they knew globalisation was coming with such force. There is a good deal of luck in both policymaking and punditry, as *The Economist* should know only too well.

Will Hutton
London

Balkan prime ministers

SIR – I'm sure Fatos Nano will be upset to hear from Matt Reynolds that he is no longer the prime minister of Albania (Letters, January 22nd). Ramush Haradinaj (36) is actually the prime minister of Kosovo.

Rob Ayasse
Brussels

ONLINE ARTICLES

The following correspondence refers to articles published only online

Carrots and sticks

SIR - To suggest that the Bush administration deserves “full points for foreign policy boldness” (“More sticks, and the odd carrot”, Economist.com, January 18th) seems inconsistent with your disdain for the misadventure in Iraq. Would Hitler get "points" from *The Economist* for his boldness in foreign policy?

Mark Wilber
Oakland, California

Palestine

SIR - Israeli soldiers and settlers have been methodically misdirecting our attention, and even our

sympathy, for years ("Abbas sends in his men", Economist.com, January 21st). The dream and the possibility of a Palestinian state has been usurped by racist Israel so as to create a disjointed series of crowded concentration camps for the Palestinians. As long as Mahmoud Abbas is a satisfactory prison guard, Israel might refrain from destroying him.

Anne Selden Annab
Mechanicsburg, Pennsylvania

SIR - Having read your article, I couldn't help feeling that perhaps it was influenced by Zionist concepts of the nature of Palestinian violent resistance to the occupation. Mahmoud Abbas has declared that he is not going to start a civil war in Palestine, even if Ariel Sharon or George Bush demands it. He, and Hamas, have the same aims in the struggle with Israel. They want justice over refugees, settlements and occupation, and they want Israel to comply with international law over all three.

Mr Abbas will not agree, nor should he, to defer negotiations while the Israeli withdrawal from Gaza takes place. Of course the withdrawal is important, but 8,000 settlers can hardly be seen as significant compared with the 450,000-plus illegal settlers in the West Bank and Jerusalem. Sadly, Mr Sharon has a longtime habit of drawing red herrings across his ever-expanding demands over these territories.

Christopher Leadbeater
Ashford, England

Eradicating poverty

SIR - There is more intellectual grunt devoted to marketing a single new laundry product than there is to eradicating poverty in the third world ("Whatever it takes"), Economist.com, January 17th). More money may be necessary, but it will not be sufficient unless it harnesses the ingenuity of diverse, responsive minds and is tied to achieving explicit, verifiable outcomes that are meaningful to real people.

My suggestion is that the rich world auctions freely tradeable bonds that would become redeemable only when a specified social objective has been achieved in the poor countries that would receive the proceeds. These objectives could include conflict reduction, increases in basic literacy, and reductions in disease and hunger. By contracting out the achievement of poverty reduction to the private sector, such bonds would inextricably link rewards to outcomes rather than inputs, outputs, activities or institutions; and they would inject the market's incentives and efficiencies into the eradication of third-world poverty.

Ronnie Horesh
Wellington, New Zealand

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Iraq's election

Hopeful turning point, or descent into chaos?

Jan 27th 2005 | BAGHDAD AND BASRA
From The Economist print edition

AP

Sunday's ballot could make a big difference, but only if a new Iraqi government and the Americans rethink their failing strategy

IT WILL probably be one of the messiest and most dangerous elections in living memory. In four of Iraq's 18 provinces where the Sunni Arab insurgency is strongest, including parts of Baghdad, there may be mayhem on January 30th or, very probably, a derisorily low turnout. In at least another four provinces (see map below), fear of bombs and bullets is rife. The insurgents, who have promised to kill voters and make a mockery of the polls, may seek to “play away from home”, as a British diplomat puts it, by perpetrating terror in previously quieter areas.

Yet there is a surge of hope amidst the terror. While the fifth of Iraqis who are Sunni Arabs are largely but by no means entirely opposed to the election, nearly all Kurds and a very large majority of Shia Arabs, who make up another fifth and around three-fifths of Iraqis respectively, are fiercely in favour. Even if most of the Sunni Arabs voluntarily boycott the polls or are frightened away, the chances are that two-thirds of Iraq's 14m-odd eligible voters, in a population of some 25m, may vote in a genuine multi-party election—a dazzling rarity in the Arab world—for the first time in half a century.

No fewer than 84 parties and 27 candidates running on their own are stuffed into a national list from which voters may choose their members of a national assembly. In truth, no one knows who will prevail. The likeliest outcome is that the United Iraqi Alliance (better known by Iraqis as “the Shia house”, “the clerics' list” or simply “169”, after its number on the vast ballot paper) will do best without winning an outright majority: the country's most influential clergyman, Grand Ayatollah Ali al-Sistani, helped draw up the list, though without formally blessing it.

A catch-all Kurdish Alliance is sure to sweep up the vast majority of Kurdish votes. And a list headed by the interim prime minister, Iyad Allawi, a secular Shia whose party was funded in exile by the CIA and who has also reached out to members of the former ruling Baath Party and assorted Sunnis, may do better than was once expected, thanks to an image of toughness and steadiness burnished by him during his past six months in office.

Seats for the 275-member assembly will be allocated by pure proportional representation, so that any party polling at least 1/275th of the total number of votes cast will get a seat. According to the interim constitution, a new government must be formed within a month of the poll. The new assembly must first vote for a president and two vice-presidents who, in turn, as a presidential council, must unanimously choose a prime minister. He must then choose a government, which must be endorsed by a simple majority of the assembly's members. At least one-third of candidates in every party have been required, by law, to be women.

Perhaps more important, the assembly must oversee the writing of a new and final constitution, to be drafted by mid-August, endorsed in a referendum by mid-October, leading to a full general election under new rules by mid-December. The interim constitution provides for a six-month slippage in the timetable if the constituent assembly gets stuck in argument. And if two-thirds of the voters in just three provinces reject the new constitution, the process must start again. That means that the Kurds, who control three provinces, in effect have a veto. But so do the minority Sunni Arabs.

The likely outcome of the election is that a coalition will emerge, involving the Shia house, the Kurds, Mr Allawi's lot and several Sunni Arab-led parties. The likeliest sort of constitution, provided that the three main components of Iraq (Sunni and Shia Arabs and Kurds) accommodate each other, is a strongly federal one in which Islam is a main—but not the sole—source of law. There must also be a guarantee that the country's natural resources, meaning mainly oil, are equitably shared between all provinces.

But the violence blocks the lot

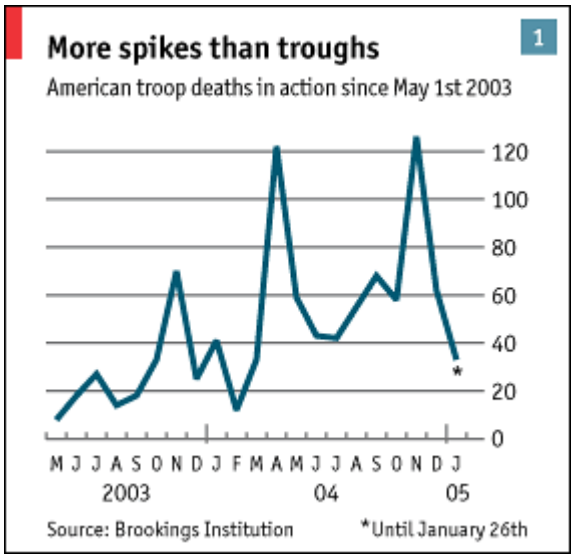
All this, however, seems immaterial while the insurgency rages (see chart 1). The number of attacks on Americans, though not as frequent as in November, is more than four times the rate of a year ago; the death rate is nearly twice as high; and more than three times as many Americans are being wounded than a year ago, according to data collected by the Brookings Institution, a think-tank in Washington. American officers say their troops are subjected to some 70 attacks a day. Since the American invasion, nearly 1,100 have died in combat and another 250 or so in accidents.

Even more grimly, the tally of Iraqi civilian deaths continues to rise inexorably. According to IraqBodyCount.com, an anti-war but fastidious American group, between 15,000 and nearly 18,000 Iraqi civilians have been killed since the American invasion in March 2003; other human-rights organisations have suggested twice as many, or even more.

By a Brookings estimate based mainly on Pentagon briefings, some 32,000 insurgents have been killed or captured since the conventional phase of the war ended in April 2003. Yet the number of active insurgents, though hard to count, is plainly swelling. The head of Iraq's intelligence service suggested last month that there were 40,000 hard-core rebels, with another 160,000-odd Iraqis helping them out. That is several times the standard, albeit rough, estimate of a year ago.

It is plain that many units of American troops, who now number 150,000 out of an allied total of 175,300, adopt a “shoot first, ask questions later” approach. Some 8,000 Iraqis are currently detained on suspicion of insurgency. Photographs of the mistreatment and humiliation of Iraqi prisoners by American and British soldiers have seared themselves into the Iraqi national consciousness. Virtually every opinion poll (however rough and ready) and a heap of anecdotal evidence suggest that most Iraqis, bar the Kurds, place the overwhelming burden of blame for their misfortunes on the Americans.

As the Americans have sought to build up the pro-government Iraqi army, national guard (a civil-defence force) and police, the insurgents have begun to single out perceived collaborators as targets. In the last four months of last year, around 1,300 Iraqi policemen were killed, compared with 750 in the first nine months of the year; some 1,500 recruits have been killed, nearly 800 of them in a four-week period towards the end of last year. Though the new Iraqi forces are ethnically mixed, the targeting of some units by the insurgents hints at a deliberate stirring of sectarian hatreds.



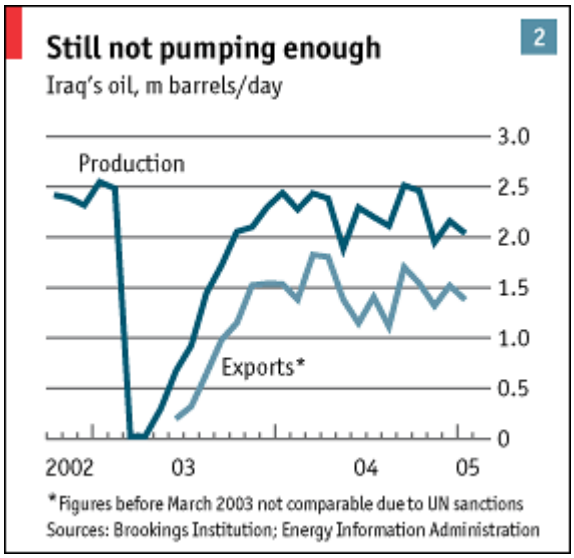
More than two-thirds of American deaths have occurred in just two provinces: Anbar (including Fallujah and Ramadi) and Baghdad. But Iraq's four biggest cities—Baghdad, Basra, Mosul and Kirkuk—all echo daily to gunfire and explosions. Though it is the biggest city of the supposedly quiescent Shias, Basra is highly dangerous too. Since the Americans recaptured the insurgents' hotbed of Fallujah in November, their enemy has switched his focus to the northern city of Mosul, a religiously and ethnically explosive city now starkly divided on either side of the Tigris river. For electioneers, western Mosul—the Sunni side—has been a no-go zone.

Moreover, the current relative calm among the Shia Arabs could be illusory. The notion that all but four provinces are safe is false. Armed gangs and a vast criminal underworld hold sway in many parts of the country. A rebellious young clerical firebrand, Muqtada al-Sadr, and his thuggish militia, known as the Mahdi Army, have been lying low since Mr Sistani talked them out of their rebellion against American occupation late last summer. But they control swathes of the centre and south, and the Americans have consistently underestimated the Sadrists' power and reach. Though Mr Sadr himself is staying out of the election fray, he might well urge his men to rise up again if he or his group were cut out of a power-sharing deal.

The safest part of Iraq is Kurdistan, which has ruled itself since Saddam Hussein lost his first Gulf war against the Americans in 1991. But even here, tension is growing. The disputed city of Kirkuk and its oil-rich, ethnically mixed surroundings are a tinderbox. After bitter pre-election wrangling, it has been agreed that Kurds displaced by Mr Hussein in his brutal Arabisation campaign will be able to vote, so tipping the demography back towards them. Again, Sunni Arabs are furious.

Meet the likeliest candidates

Across Iraq, campaigning has been largely by poster, with only the more prominent and better-funded politicians appearing on state television and even satellite channels. Awareness of the candidates is pretty hazy. Still, there is plainly a choice. Of the biggest two Shia-led parties, the main difference is on Islam: the tint of Mr Allawi's group is more secular and less sectarian, while the picture of the bearded Mr Sistani on the United Iraqi Alliance posters conveys its more Islamist tone—though its proponents stress that they do not want Iraq to go down an Iranian path towards theocracy. “We will have no turbans in the government,” says one of its leaders.



Of the two best-known parties within the "Shia house", the Supreme Council for Islamic Revolution in Iraq (SCIRI), led by Abdul Aziz al-Hakim, a clergyman, is taking pains to distance itself from its past as an Iranian-backed group that would impose *sharia* as the law of the land. The older Dawa party, led by Ibrahim al-Jaafari, a medical doctor, likewise is seeking to stress its unsectarian tolerance.

The most notable and surprising new star in the Shia house is Ahmad Chalabi, once the darling of America's ruling neo-conservatives, who had hoped (before they ditched him) that he would become the leader of a new, western-oriented, secular-minded Iraq. Once excoriated by his Iraqi rivals as an American and (worse) an Israeli stooge, Mr Chalabi is an astute fixer who may well play a part in post-election coalition-building.

Two able technocrats who have been mentioned, among others, as possible prime ministers are Hussein Shahristani, a former nuclear scientist who labels himself an independent within the Shia house and is a confidant of Mr Sistani, and Adel Abd al-Mahdi, the interim finance minister, a SCIRI man. But it is conceivable that the emerging three-man presidential council may propose to keep the stoical Mr Allawi as prime minister.

It has not all been unremitting gloom and doom. The totalitarian clamp of Mr Hussein has been lifted. The notion of a federal state has been broadly accepted. A new currency has stayed steady, and workers in the public sector, including teachers and doctors, have seen their wages rise as much as 40-fold. But virtually everything is being kiboshed by the insurgency. Unemployment is stuck, officially, at 30-40%, though some economists say that in fact more than half of Iraqis are jobless. Basic utilities are still wretched. Last week, nearly half of Baghdadis had no running water. Motorists are again queuing, sometimes for 12 hours, to fill up with petrol.

Above all, oil production and exports are still far below hoped-for levels, knocking 15% off expected revenues. In December, some 2.2m barrels a day were being pumped, against a projected 3m b/d, the pre-war figure. Shortfalls are largely due to war and sabotage. Last year saw 146 officially recorded attacks on the oil system.

The spectrum of insurgency

The mantra of Mr Allawi and his American sponsors has been that, provided the Americans do not cut and run, the insurgency can be contained, if not beaten. Their main plan is to beef up the

home-grown Iraqi forces (now totalling 127,000 against an eventual goal of 273,000), enabling the Americans and their allies, numbering 28 countries, to wind down steadily from their present troop numbers.

This, within the next few years, is a false hope. The Iraqi forces are utterly feeble. At present, only some 5,000 of them are a match for the insurgents; perhaps as many as 12,000 are fairly self-sufficient. Most of the rest are unmotivated, unreliable, ill-trained, ill-equipped, prone to desertion, even ready to switch sides. If the Americans left today, they would be thrashed. Indeed, as things now stand, politically and militarily, the war is unwinnable.

For sure, the steady “Iraqisation” of the forces is vital for any new government. But it is more vital still that it acts at once on the political front, to bring as many as possible of Iraq's Sunni Arabs into the new order. It is vital, too, that one of the presidential council is a Sunni Arab. The new assembly is likely to empower a committee to start drafting a new constitution: Sunni Arabs must be well represented on it.

The new government must also reach out to spokesmen for the insurgency, which is far from monolithic. Indeed, no one is sure how to configure it. A year or so ago, the CIA reckoned that 40-60 groups were acting more or less independently of each other, though they now seem to be co-ordinating their attacks more than before. But there is a spectrum of rejectionists. The new government must try to pick away those who might talk from those who are bent on eternal war against western civilisation.

At the wild end of the spectrum is Abu Musab al-Zarqawi, a Jordanian who aligns himself with Osama bin Laden. In terms of the overall insurgency, his role is probably much exaggerated, though his blood-curdling website and penchant for suicide-bombings and for beheading victims puts him in a league of his own. The next-most-obdurate, along the insurgent spectrum, are the Baathist professionals, especially those who were in the Mukhabarat (the secret service), for whom any deal with the new order is probably anathema.

Though there is a trend towards an Islamist world-view, most insurgents are above all nationalists. The government might accommodate many of them if they could be convinced that the Americans were certain to leave: at least soon, if not immediately.

The nearest thing to a voice of the insurgents has been the Muslim Scholars' Board, which speaks for some 3,000 Sunni mosques in the Arab parts of Iraq. Several of the board's members, while urging a boycott of the general election, have also urged Sunni Arabs to take part in the post-election constitutional debate and in provincial elections also being held on January 30th. A number of anti-occupation, anti-election academics and sheikhs have made similar suggestions. Getting such Sunnis on side is an early challenge for whoever becomes Iraq's new leader.

AP

The question of America's withdrawal

The trickiest issue that bears upon the insurgency—and on the ability of a new government to divide the rebels and draw some of them back on board—is the question of American and foreign troops. If these clearly seemed part of the problem more than the answer, a new government could ask them to leave; but that is barely conceivable in the short run, because any government is bound, for now, to rely heavily on American force for its mere physical survival.

A new government could, however, spell out a rough timetable for a foreign-troop drawdown, dependent on the build-up of Iraqi troops and on a reduction in the level of the insurgency. But that might make the government still more patently hostage to the insurgents. Some voices in the Sunni rejectionist camp have aired the possibility of a ceasefire if the Americans promised, in principle, to leave in, say, six months. That is unthinkable for the moment, but may offer a chink of light for negotiations.

The chief problem?

There is no sign that President George Bush or his generals are contemplating a rush for the exit. But they and their executives on the ground, principally the ambassador in Baghdad, John Negroponte, appear so far to have no clear alternative plan, beyond waiting to see whether the hoped-for sense of greater legitimacy accruing to the new government will give it more clout to fend off the insurgents.

Other counsellors in Washington, who broadly supported the Iraqi venture but have grave doubts about the efficacy of present political and military policy, such as Henry Kissinger and George Shultz, both former secretaries of state, are urging the administration to recruit other countries as intermediaries, as happened over the Balkans. The UN still sounds wary of deeper involvement. Yet there is a growing sense in Washington that, for one thing, the war as it is presently being conducted is unwinnable and that, for another, a new government in Baghdad must change political tack to survive.

For the past year, chaos has increased, along with ordinary Iraqis' hatred of the American occupation. But they also hate “the beheaders”: the likes of Mr Zarqawi. The emergence of a new government with a popular mandate will not change the situation overnight. It may be too late for any government seen to be sponsored by the Americans to establish itself. Nothing is certain—except that much more blood will be shed, and even more if Iraq's Sunni Arabs continue to feel disenfranchised.

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The economy

Storm clouds ahead

Jan 27th 2005 | WASHINGTON, DC
From The Economist print edition

The economy seems a bright spot for the president. But higher interest rates could make his second term much harder

Get article background

GEORGE BUSH'S second term has already had its hiccups. Barely had the president delivered his soaring, Kennedyesque inauguration speech, proclaiming “the ultimate goal of ending tyranny in our world”, than the White House was furiously clarifying that this did not actually imply any change in foreign policy. And long before Mr Bush's state-of-the-union address on February 2nd, his main priority at home, reforming the Social Security pensions system, is in trouble. Democrats seem united against change, and some leading Republicans are publicly pouring cold water on the idea.

Meanwhile, the budget picture seems to be getting worse. On January 25th, the Congressional Budget Office, Washington's independent bean-counter, projected that this year's deficit would reach $368 billion. That excludes the cost of the Iraq war, which the CBO thinks will be $30 billion this year. On the same day, the White House announced that it needed $80 billion more for Iraq and Afghanistan (bringing the total cost of both wars to almost $300 billion), and offered its own estimate for the 2005 budget—a new record deficit of $427 billion. That may be pitched deliberately high, to force Congress to control spending, but Mr Bush's pledge to halve the deficit in his second term looks increasingly empty.

All in all, not a great start. So what a relief that one thing looks good for Mr Bush: the economy. America is currently doing rather well, with relatively healthy growth in jobs and extraordinarily low interest rates. Alas, it is a combination that is unlikely to last—and if the economy gets bleaker, that could start to affect Mr Bush's other plans.

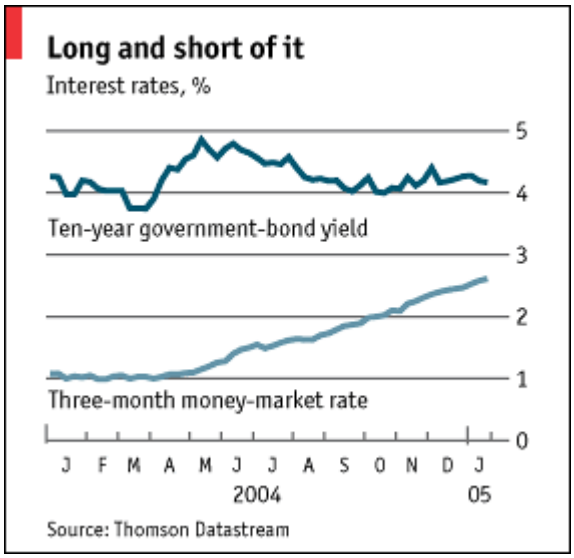
Consider the good news first. From industrial production and retail sales to housing starts, the latest statistics have been stronger than expected. Consumer confidence rose in January for the second month in a row. Although most analysts reckon that GDP growth slowed from its 4% pace to closer to 3.5% during the last three months of 2004 (the first official estimates are released on January 28th), that hardly looks weak.

While the economy is clearly working off its slack, inflation is still low enough to cause few palpitations. Headline consumer-price inflation has slowed slightly, to 3.3% in the year to December, thanks to falling oil prices. Core inflation, which excludes the volatile categories of food and energy, has doubled over the past year, but from a rock-bottom level: it climbed from 1.1% in 2003 to 2.2% in 2004.

As a result, America's central bankers have been able to inch up short-term interest rates at what they call a “measured” pace—a phrase now synonymous with regular rises of 0.25% in the central bank's federal-funds rate. At its next meeting, on February 2nd, the Federal Reserve seems likely to raise short-term interest rates to 2.5%. That will be double the level of only seven months ago, but it is still extremely low. Depending on what measure of inflation you use, real short-term interest rates are around zero or still negative.

If America's economy continues to grow robustly, monetary policy will shift from “loose” to “neutral”—and rates will go up. Although there is plenty of controversy about what a neutral fed-funds rate might be, estimates tend to be 3.5-5.5%. Oddly, financial markets are pitching it lower. Futures contracts imply that the central bank will raise short-term rates at each of its next three meetings to 3%, but will then stop, so there will be virtually no more Fed tightening in the second half of 2005 or in 2006.

If that is puzzling, the behaviour of long-term interest rates is even odder. At around 4.2%, yields on ten-year Treasury bonds, America's benchmark long-term interest rate, are virtually identical to where they were a year ago (see chart). Adjusted for some measures of inflation, real long-term interest rates are lower. Stephen Roach of Morgan Stanley reckons inflation-adjusted long-term rates are now more than 2.5 percentage points below their average level of the past 20 years.



This long-term rate has a big impact on how much American companies and consumers borrow, and thus on the American economy and Mr Bush's second term. Its level reflects all sorts of things, including demand from investors for bonds, expectations of future inflation and a risk premium for holding longer-term assets. But if you look at what has happened to America's economy over the past year, you would expect long-term rates to be heading much higher. After all, short-term interest rates and inflation are both rising, the current-account deficit is huge and widening, the dollar has fallen and the fiscal outlook has worsened. Surely investors looking over the next ten years will want a better return than 4.2%?

Economists are genuinely puzzled by all this. There are several explanations, each of which has a different implication for Mr Bush's second term. None of them are terribly good.

• The most gloomy theory is that America's economy is, in fact, rather more fragile than the current statistics suggest (and most forecasters presume). Debt-laden American consumers, so the argument goes, will not be able to sustain their current spending patterns, particularly if the housing bubble bursts. Low long-term interest rates, far from being out of kilter, are actually an accurate sign of incipient economic weakness. Mr Bush's second term, in other words, may see another sharp slowdown—not a good backdrop to his domestic revolution.

• A more hopeful argument for Mr Bush is that there has been a deeper “structural” change in the investment markets in favour of bonds. A new theory on Wall Street is that domestic pension funds are shifting more of their cash into long-term bonds in advance of possible regulatory changes from Washington. Asia's central banks have also been buying Treasury bonds to stop their currencies appreciating against the dollar; that demand has certainly pushed down the yields on American bonds, but nobody really knows by how much or how much longer the Asians will continue to be such unchoosy investors. If the Asians were to moderate their appetite, interest rates would shoot up.

• A third theory is that investors are so convinced by the Fed's record as an inflation-slayer that they don't need higher rates on long-term bonds. Overall inflation is indeed much lower than it was a generation ago. But plenty of aspects of America's economy should spook even the most trusting admirer of Alan Greenspan (not to mention the Fed chairman himself). These include that worsening budget outlook and America's rising reliance on foreign capital.

• Which leaves the last possibility: that the financial markets have temporarily mispriced the risks involved. Investors are too complacent about inflation and about America's enormous budget and

current-account imbalances. If that theory is correct, long-term interest rates could rise sharply and suddenly.

And if rates went up?

Higher interest rates would obviously hurt America's debt-laden economy. But they could also play havoc with Mr Bush's political goals. The “ownership society” would lose allure if the housing market and the stockmarket tumbled. Halving the budget deficit would be both more difficult and more necessary. Convincing lawmakers to support pension privatisation that required issuing an extra $1 trillion-2 trillion of debt would be even harder.

Just how the interest-rate puzzle will be resolved is unclear. But the chances are that either America's economy will do worse than many now expect or interest rates will head much higher. For the White House, neither prospect is appealing. These past few weeks have hardly been a political honeymoon, but the going could get much, much tougher.

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Employment

Workers or shirkers

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From The Economist print edition

A puzzle over America's shrinking labour force

MOST Americans seem to have more work to do than ever. But why are so many of them dropping out of the labour force?

The proportion of working-age people who have a job or are hunting for one is supposed to grow in a recovery. Yet the "labour-force participation rate" has been slipping ever since it reached 67.3% in 2000, leaving it at 66% today. Oddly, it's the young and the middle-aged who are leaving the workforce, while the old are joining it in greater numbers. This is a puzzle. Normally, when economic growth rebounds, so does participation.

One explanation is that, despite a rather low unemployment rate of 5.4%, the economy is still weak. People may have stopped hunting for jobs and therefore aren't popping up as "unemployed". Some of these people are no doubt living off a spouse's income. But others, it seems, are relying on disability benefits: from 2000 to 2003, 1.8m more have claimed them, thanks in part to changes in the system that have made it far easier to join the rolls. Many of these people, argues Larry Katz of Harvard University, are probably only marginally disabled (a spot of back pain perhaps) and would otherwise be working.

Another explanation, proposed by Roger Ferguson, vice-chairman of the Federal Reserve, is a permanent structural shift in the economy away from declining industries. Put simply, laid-off factory workers cannot go back to the same old jobs. Since these blue-collar types lack the skills

to work in a different industry, and dislike re-training, many have opted for early retirement.

Another principal group to blame is women. The participation rate of women in the workforce climbed steadily after the second world war to 60% in 1999, but Meg McConnell and Charlie Himmelberg of the Federal Reserve Bank of New York argue that the unusual bonanza of the late-1990s bubble economy masked an overall slowdown in the rate at which they joined it. Now that the generous perks have gone, many women have withdrawn.

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The Bush presidency

Shock and awe

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The gap between rhetoric and reality is growing in the White House

MOST presidents get more defensive and hesitant as they go on. George Bush is getting bolder. Since his re-election, the president has committed himself to transforming, among other things, Iraq, the Middle East, the tax system, pensions and the legal system. Phew. If he were allowed to win a third term, what would he do for an encore?

Yet the gap between Mr Bush's rhetoric and what is actually happening, or is likely to happen, is embarrassingly wide. The day after his “freedom speech” his officials fanned out to explain that he didn't really mean anything specific. In Iraq things are not going according to plan—if indeed the administration actually has a plan (see article). Tax reform has been sidelined to a commission, with action this year, next year, sometime. His attempt to privatise part of the Social Security system is in trouble even before it starts.

The gap between ambition and follow-through at home can partly be blamed on the fact that Mr Bush has yet to start revealing the details of his policy. But in foreign policy, the contradiction looks well established. Neo-conservatives, who loved the inauguration speech, claim that Mr Bush is undermining it through the people he has appointed. Condoleezza Rice, the newly confirmed secretary of state, needs watching. Bob Zoellick, her chosen number two, seems to know far too many foreign ambassadors. As for Nicholas Burns, touted for number three, he lives in Belgium. And now Douglas Feith, one of the few neocons with real power, is leaving the Pentagon “for personal reasons”.

There is often a gap between promise and achievement in politics—and nearly always one in inauguration speeches, which are supposed to be aspirational. What is unusual about Mr Bush's ambition is the way it is centred on what might be called “discretionary policies”.

Social Security privatisation, tax reform, the overthrow of Saddam Hussein and the “war on tyranny” are all causes Mr Bush chose to espouse. He was not forced to take them on by events, and no one would have censured him (much) had he not mounted these hobby-horses. In contrast, many of his other policies have either been “reactive” (the overthrow of the Taliban, the “war on terror”) or are more conventional, with deep roots in Republican tradition (like cutting taxes).

The discretionary element makes Mr Bush's job much harder. Compare, for instance, the bipartisan support Mr Bush received for his “reactive” war in Afghanistan with the more patchy support he received from Democrats for his discretionary quest in Iraq; or the initial acclaim for the “war on terror” with the mixed response to his new “war on tyranny”.

And this is about to get worse. In pursuing his earlier aims, Mr Bush either had the country behind him or, if not, could get his policies implemented because they united his party and divided

Democrats (this was the case with the tax cuts). But now, his “discretionary” wish-list is not popular (most people oppose Social Security privatisation). And it is dividing his own party while uniting Democrats.

Mr Bush has already had trouble with supporters in the House of Representatives who held up a bill on intelligence reform. Now, several Republican congressmen have begun to ask pointedly why the president is in such a hurry to reform Social Security, whose solvency problems are not as bad as Medicare's. And the opposition has rallied around the cause of stopping “privatisation”.

Ronald Reagan also had grand ambitions and an unco-operative Congress. He got round the problem by winning over the country—which then put pressure on its elected representatives. But Mr Bush's approval rating is only around 50%, considerably lower than that of any recent re-elected president. Even evangelical Christians, his most faithful (excuse the term) supporters, are displaying anxiety. The *New York Times* has reported that a group of conservative churches wrote to the president's chief adviser, Karl Rove, asking why Social Security reform has been given priority over a constitutional amendment banning same-sex marriage (on which Mr Bush told the *Washington Post* on January 16th that “Nothing will happen”).

Even partial reform of Social Security, a modest tax simplification, and a slightly democratic and stabler Iraq would be considerable achievements. But Mr Bush's revolutionary rhetoric has left plenty of room for disappointment.

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Verve and the Democrats

The Boxer rebellion

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Has the left found its La Passionara?

EPA

Speaking for the silent

BEING parodied on “Saturday Night Live” is a backhanded tribute to political significance. Last weekend saw “Barbara Boxer” grilling “Condoleezza Rice” in the Senate, using an increasingly bizarre series of props. Starting out by waving a large scorecard-figure zero (“how many weapons of mass destruction found in Iraq”) and a graph with a tiny yellow bar (for “the truth”) and a large blue bar (“what you say”), the Californian senator graduated to pouring vinegar (“your lies”) and baking soda (“our current situation in Iraq”) into a plaster-of-paris volcano (“the rising tension in the Middle East”). Mrs Boxer's “lie volcano” duly erupted.

The feisty Mrs Boxer has become a heroine to the left. She was one of only two senators in committee hearings to vote against Ms Rice's nomination (John Kerry was the other). She was also the only senator to challenge George Bush's election, holding up the formalities to question the certification of Ohio's electoral-college vote.

Of course, none of this has made any official difference. Mr Bush became president and the Senate approved Ms Rice this week by 85 to 13 votes. But it has electrified the left. Activists deluged her office with praise for forcing a congressional debate on voting rights.

More surprisingly, moderate Democratic senators privately wish her well for (in their view) calling the Bush administration to account for its duplicity in foreign policy. They share her suspicion that “loyalty to the mission overwhelmed [Ms Rice's] respect for the truth”, but senators who represent Republican states or who have narrow majorities are afraid to say so. Mrs Boxer, who was re-elected in November by 2m votes in deep blue California, has at least six years to express the inexpressible frustration of her peers.

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Native American women

In Ms Mankiller's footsteps

Jan 27th 2005 | PINE RIDGE, SOUTH DAKOTA
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From chiefs to "chairwomen", but progress nonetheless

THE Sioux Indians are famous for their warrior chieftains, such as Sitting Bull. Hence the significance of the recent inauguration of the first woman ever to head the Oglala Sioux. In December, Cecilia Fire Thunder, a 58-year-old former welfare recipient, lobbyist and community organiser, took office on the Pine Ridge Indian reservation in South Dakota. She was chosen over Russell Means, a famous figure in the national Indian movement.

In a ceremony filled with tradition, from ritual dancing to speeches in the Lakota language, Ms Fire Thunder was installed as chairwoman (sadly, her official title) of a 46,000-member tribe based on one of America's largest reservations. "The spirits of my ancestors made a decision for me to run," she says. "I asked for their guidance and their permission, and I was chosen by the people."

Ms Fire Thunder is not alone. Across America, Indian women are coming to the fore. There were plenty of tribal chairwomen and chiefs representing their nations at George Bush's inauguration. Another new tribal chairwoman is Erma Vizenor, who was made head of the White Earth Chippewa in Minnesota, after earning a doctorate from Harvard and helping to get her tribe's former leaders convicted on federal charges.

Next week sees the publication of an annual report on the state of the Indian nations. It is likely to say that the tribes have done slightly better recently, albeit from a wretchedly low starting point. Income per head on the reservations was barely one-third of the national average in 2000, but researchers at Harvard have also found that Native Americans narrowed the gap during the 1990s.

The introduction of ever-bigger casinos and more self-government have played a role in this; but so have women. Today, in addition to the chairwomen, more of them sit on tribal councils or serve as tribal secretaries and treasurers. The executive director of the National Congress of American Indians (NCAI) is a woman, Jackie Johnson; they also play a prominent role in the Native American Bank (NAB).

For many Indians, this trend represents a reversion to life before white culture largely destroyed it. Many tribes were matrilineal: land, livestock and family names were passed down through women. In some places, women chose the men who governed. Even in patrilineal tribes, women served as clan mothers, advising men behind the scenes. This social order was changed by outsiders, especially the United States government, which sought out Indian men to sign treaties in the 19th century.

A breakthrough for women came two decades ago, when Wilma Mankiller of Oklahoma was elected principal chief of the Cherokee Nation, the second biggest tribe. She recalls battling prejudice and doubts. Even then, though, women often held the steadiest jobs on the reservations, as teachers or social workers; and the growth of tribal colleges—institutions on the

reservations that offer courses in native language and culture, as well as professional training—has helped even those who stay at home to pursue an education.

The American Indian College Fund says two-thirds of students at tribal colleges nationwide are female. At Oglala Lakota College, on the Pine Ridge reservation, the figure tops 70%. There, the average student is a 30-year-old woman with two or three children. Tom Short Bull, the president of the Oglala Lakota, laments the shortage of male students, though he wonders “even if we did train them for a position, what jobs would they go into?”

Indeed, Ms Fire Thunder has a challenge on her hands. The jobless rate at Pine Ridge is 85%. Alcoholism and domestic abuse are common. Most of the money coming into the tribe is from federal grants of one sort or another. Ms Fire Thunder, who sees herself as a chief executive—albeit with spiritual guidance from the elders—is busy trimming budgets and asking for PowerPoint presentations from every department.

One female-run group that might serve as a model is the Oneida tribe of Wisconsin. In the 1970s, the tribe had double-digit unemployment; now it employs 3,000 people (including non-Indians) who work in its hotel, conference centre, community bank and industrial park. The Oneida, together with several other tribes, have just opened a new Marriott hotel in Washington, DC. Cristina Danforth, the Wisconsin Oneida's chairwoman, says 92% of revenue comes from tribal enterprises and only about 3.5% from the government.

One reason why women may be doing so well on the reservations is their refusal to wallow in self-pity. Many Indian men are always harking back to a more heroic past. In a book on native women that she published last year, Ms Mankiller quotes a Mohawk proverb: “It is hard to see the future with tears in your eyes”.

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Johnny Carson

America's nightcap

Jan 27th 2005 | LOS ANGELES
From The Economist print edition

The lure of Nebraskan wit and loud jackets

Globe Photos

He put Burbank on the map

"HEEEEEERE'S Johnny", went Ed McMahon's ridiculously exaggerated intro—and Johnny Carson, with his checked sports jackets and garish ties, would step through the curtain, give a wry grin to the cameras and proceed to entertain the nation with a late-night menu of deadpan jokes, Hollywood guests and musicians. From 1962, when he inherited NBC's "Tonight Show" from Jack Paar, until 1992, Mr Carson defined late-night television, and, in part, American culture. As Bob Hope once said: "He changed people's sleeping habits, sex habits and their midnight eating habits."

Doubtless that is why when Mr Carson—of his own volition—at last retired, more than 50m Americans tuned in for the final show. This week, when he died from emphysema at the age of 79, the tributes were uniformly generous, whether from George Bush or Bette Midler or the *New York Times*.

One justification for the nostalgic acclaim is that Mr Carson was, indeed, a master of his craft. With a nice touch in self-deprecation, he could rescue himself from a joke that had bombed. He could put the nervous at ease, and puncture the pompous. He could spot talent for his show and not be afraid to let it outshine the host: Jay Leno (his successor on the "Tonight Show"), Barbra Streisand, Woody Allen, Jerry Seinfeld and Ellen DeGeneres all owed much to him. Best of all, his Nebraskan, middle-America persona gave him licence to launch well-aimed political barbs ("You get the feeling that Dan Quayle's golf bag doesn't have a full set of irons.").

But another reason for the nostalgia is the recognition that the Carson era of television has gone for good. Each weekday night, from the 1960s through the 1980s, up to 15m Americans would stay up to watch him. An extraordinary 45m viewers, a fifth of the population, watched the 1969 show in which the falsetto-voiced Tiny Tim married Vicki Budinger, a 17-year-old singer.

These days, Mr Leno's "Tonight Show" attracts an average audience of around 6.2m. This is no reflection on Mr Leno, by some way the most popular late-night TV host, but merely the result of the competition the traditional networks now face from cable channels and the internet.

On the other hand, not all of the Carson era belongs to the past. It was Mr Carson who in 1972 moved the "Tonight Show" from New York to "beautiful downtown Burbank", hence establishing Los Angeles, rather than New York, as the capital of popular culture. It was Mr Carson who cut the length of the "Tonight Show" down from 90 minutes to 60, allowing space for the late-late shows

that now follow Mr Leno and his competitors. And it was Mr Carson who took full ownership of his show and its video-cassette and other spin-offs—a formula that has helped make Oprah Winfrey and many other TV hosts extraordinarily rich.

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The oldest trade rebranded

Sex, souvenirs and non-smear lipstick

Jan 27th 2005 | RENO
From The Economist print edition

Who needs history when you've got some hookers and a gift shop?

AP

Independent contractors at play

TIRED of Disney World? Bored with the Smithsonian and the Guggenheim? Then why not take the wife and kids to the Mustang Ranch Museum and celebrate Nevada's “gift to the world”? That (minus the bit about the wife and kids) is the dream of one brothel-owner.

Can a bordello really be sold as a resort destination? Nevada is the only state in the union where brothels are legal, but prostitution is by no means a hallowed trade. Brothels are usually seedy affairs, tucked discreetly away from churches, town halls and the like (or so somebody we met in a bar once told us). But Lance Gilman, who owns both the Wild Horse bordello and the trademark for the Mustang Ranch, is building a sex village—complete with museum and souvenir shop.

George Flint, head of the Nevada Brothel Association, insists that a trip to the Mustang Ranch could be “just as important as driving to Mount Rushmore”. The businesslike Mr Gilman insists that a house of ill repute is nothing of the kind. Brothels are part of Nevada's history, and nowadays they are respectable businesses. When Mr Gilman opened the Wild Horse in 2002, he was already a seasoned businessman who had developed several industrial parks.

This is all in marked contrast to the Mustang Ranch's history. The first legal brothel in America saw the murder of a boxer, a mysterious fire and several government raids; it is also cited (unfavourably) in the Internal Revenue's tax manual. It was owned by Joe Conforte, who spent time in jail, tried to float the brothel on the stockmarket, fled charges of money-laundering, racketeering and bribery, and is now rumoured to be living in Brazil. In 1999, the government seized the Mustang Ranch (this time to shut it down for good).

When the Bureau of Land Management auctioned the ranch's assets on eBay in 2003, Mr Gilman paid $145,000 for the brothel's trademark and pink stucco building, which he airlifted to a site beside the Wild Horse. His plan was to give the Wild Horse a link to Nevada's past, some Wild West flair and a crowd of new customers, but he has run into some opposition: a rival is fighting to call his own brothel the Mustang Ranch. The brawl for the name has become so heated that a judge has declared the trademark to be temporarily off-limits. A federal court will take up the dispute in April.

In the meantime, Mr Gilman is building his Mustang Ranch Village on the plot next to the Wild

Horse. The driveway to the village is neatly lined with saplings and, at the end of the road, a row of foreign flags greets visitors as if they are arriving at an international institution. The museum will include a portrait of the legendary Mr Conforte and a circular bed with a mirrored headboard from the original Mustang Ranch. Souvenirs will range from the usual T-shirts (boasting about the Mustang's “res-erection”) to more exotic oils and toys. Because Mr Gilman's girls are experts in long-lasting “make-up that doesn't run”, a Mustang Ranch cosmetics line will also be on sale.

However, the village's main business will be a new version of the Mustang Ranch. Like the Wild Horse, the new bordello will boast the latest in management practices (the prostitutes will all be hired as independent contractors) and cleanliness (they will be tested weekly for sexually transmitted diseases). When everything is up and cavorting, Mr Gilman hopes his business will make about $10m each year. As much as $500,000 in taxes will go to Storey County: no small sum, when the county's annual budget is close to $6m.

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Lexington

Sister Hillary

Jan 27th 2005
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Can the Democrats close the God gap?

GEORGE BUSH is not the only American politician with a penchant for “God-drenched” rhetoric (to borrow a phrase from Peggy Noonan, chief speechwriter for Ronald Reagan). Last week the lioness of liberalism herself, Hillary Clinton, engaged in a bit of God-drenching of her own at a fundraiser organised by the Reverend Eugene Rivers, a leading campaigner against teenage violence. She lavished praise on faith-based organisations, repeatedly invoked God's name and declared “I've always been a praying person.”

Mrs Clinton's speech was part of a growing debate on the left about how to close the God gap. Democrats want to change the focus of religious debate from abortion and gay marriage to, say, war and poverty. Jim Wallis, who has the rare distinction of being both an evangelical preacher and a Kerry voter, points out that the Bible has 3,000 references to alleviating poverty.

Democrats are also talking about softening their image on divisive cultural issues, particularly abortion. Howard Dean urged his party to embrace pro-life Democrats. Tim Ryan, a Democratic congressman from Ohio, pointed out that his party has paid a heavy price in the heartland for its inflexibly liberal position on partial-birth abortion and parental notification. And the hyperactive Hillary told a throng of pro-choice activists not only that abortion represents “a sad, even tragic choice to many, many women” but also that “religious and moral values” are the primary reason why teenage girls abstain from early sexual activity.

Remarkable stuff—and more proof of Mrs Clinton's political maturity and ambition. But do the Democrats have a prayer of recapturing the religious vote? The optimists argue that they have both history and public opinion on their side. Look at history, and you can see the religious left at the heart of America's great social-reform movements, from the fight against slavery to the New Deal to the civil-rights movement (for some reason, Prohibition is usually left off the list). Look at public-opinion polls, and you can see that the religious right is a balloon waiting to be pricked. The latest Pew poll shows that roughly six in ten Americans want politicians to make helping the poor and needy a top priority, compared with just one in four who want to give a high priority to banning gay marriage. A sizeable number of evangelical Christians are blue-collar workers who like left-wing economic policies as well as conservative social policies.

All this sounds plausible until you take a look at today's religious left. To begin with, it is split by race. The black churches (such as the one that Mr Rivers runs) are vigorous enough, but their impact is necessarily limited. The white churches include all the mainstream denominations, but they suffer from what might be called a European problem: they are haemorrhaging members and are run by an unrepresentative elite that is far to the left of the people in the pews.

The religious left is divided in almost every other way you can imagine. Some religious leftists are card-carrying Deaniacs. Thirteen of the 38 members of the Win Without War coalition are religious groups, for example. Some are left-wing on economics but conservative on culture: just ask most black or blue-collar Christians what they think of gay marriage. The US Conference of Catholic Bishops happily marches alongside the National Council of Churches on social justice but crosses the street when it comes to abortion.

The Democrats are also deeply divided about what winning the religious vote means. Does it mean moving to the left? Many religious Democrats claim Jesus was a socialist pacifist. Or to the right? Some New Democrats want to recapture “conservatives of the heart”. Or staying where they are, but sugaring their policies with a few spoonfuls of Christianity?

Secular fundamentalists

The biggest problem for the Democrats is that many of their hard-core supporters would rather lose another election than court the religious vote. Mr Wallis worries about Democrats being depicted as secular fundamentalists, but that is not far off the truth. The number of people who deny any religious identification has doubled from 14.3m in 1990 to 29.4m in 2001—and many of them will do anything to stop the Democrats from drenching themselves with God. No pro-lifer has been allowed near a Democratic podium for years. Will People for the American Way allow the Democrats to let religion flourish in the public square? Will feminists allow them to compromise on abortion? Will the Hollywood crowd allow them to crack down on obscenity? Louis Bolce and Gerald De Maio, two academics, point out that in 1996 and 2000 one in three white Democratic voters “intensely disliked” Christian fundamentalists.

Party leaders are particularly weak on the issue. It is no coincidence that the only prominent white Democrat who has made a good fist of talking about religion is Bill Clinton. Mr Dean's quest for the religious vote during his presidential run was not helped by his locating the Book of Job in the New Testament (nor by the discovery that he'd abandoned Episcopalianism for Congregationalism because of a dispute over a bike path). John Kerry sounded opportunistic when he suddenly recalled his youthful career as an altar boy.

That does not mean that Mrs Clinton is wrong to try to recharacterise her party—and herself. Barack Obama, the new Democratic senator from Illinois, has a genius for religious rhetoric. And the religious right is always in danger of over-reaching or sounding shrill (as it did in rejecting Mrs Clinton's olive branch out of hand). But the coming battles over gay marriage and the Supreme

Court will surely harden divisions, with the Republicans strengthening their grip on the religious vote and the Democrats banking on secular fundamentalists. Mrs Clinton is heading down the right path, but it will be a rocky one.

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Brazil

Taming an urban monster

Jan 27th 2005 | SÃO PAULO
From The Economist print edition

Panos

South America's biggest city is halfway towards a better, more equitable future. Can a new mayor finish the job?

MARLENE DOS SANTOS, a lively, attractive mother of six, clings to the very fringes of São Paulo. Her home is a shack on a patch of dirt that looks like part of the reservoir a few metres away. It is reached via a footbridge over a gully which carries sewage down to the city's drinking water. Mrs dos Santos spends her nights fending off rats, some of which carry leptospirosis, a nasty bacterial fever. But her main worry is that since losing her job as a cleaner six months ago she has yet to find another. Her plight epitomises what is wrong with São Paulo, the southern hemisphere's biggest city and Brazil's economic capital.

A few miles away, in the central business district, skyscrapers gleam, helicopters ferry tycoons above congestion and kidnapping, and celebrity chefs are at their ovens. São Paulo has been called a “city of rings”: a plush “expanded” centre is surrounded by progressively poorer circles. “Inequality is reflected in the physical reality of the city,” says Jorge Wilheim, who until last month was the city's planning secretary. Yet the pressing needs of people like Mrs dos Santos do not drive São Paulo's politics. In October, an election for mayor pitted an incumbent who made notable efforts to improve life in the periphery against a challenger more popular with the middle class.

The mayor, Marta Suplicy, did well in outlying districts such as Grajaú, where Mrs dos Santos lives. But she lost to José Serra, a clever technocrat and former federal health minister. He was helped by middle-class resentment of municipal tax rises and suspicions of Mrs Suplicy's party (the left-wing Workers' Party, or PT, of Brazil's president, Luiz Inácio Lula da Silva) and personal life (she divorced a popular senator and married an Argentine political fixer). Mr Serra, who took

office on January 1st, leads the Party of Brazilian Social Democracy (PSDB), the PT's main opposition. Having lost to Lula in a presidential election in 2002, his performance as mayor may have national ramifications.

Beyond promising better administration and fiscal discipline, Mr Serra has said little about where he will lead São Paulo. He takes over a city undergoing multiple transitions. Its economy is increasingly linked to the world and weighted toward services, though the wider metropolitan area remains an industrial powerhouse. New regulatory powers give government more control over land use—a chance to seize the initiative from speculators. São Paulo itself, with a population of 10.7m, is merely the largest of 39 municipalities that comprise a metropolis of 18m. There is a new awareness that all must work together, but the federal and state governments disagree over who should lead. There is an opportunity at last to devise a fairer city. But is there the will?

São Paulo was built on coffee but shaped by immigration and the car. Slaves picked the coffee. European migrants provided the labour for the city's first industries—textiles and food—at the end of the 19th century. Metal-bashing and car plants followed, many in satellite towns. From the 1950s millions of migrants flooded into São Paulo from Brazil's poor north-east.

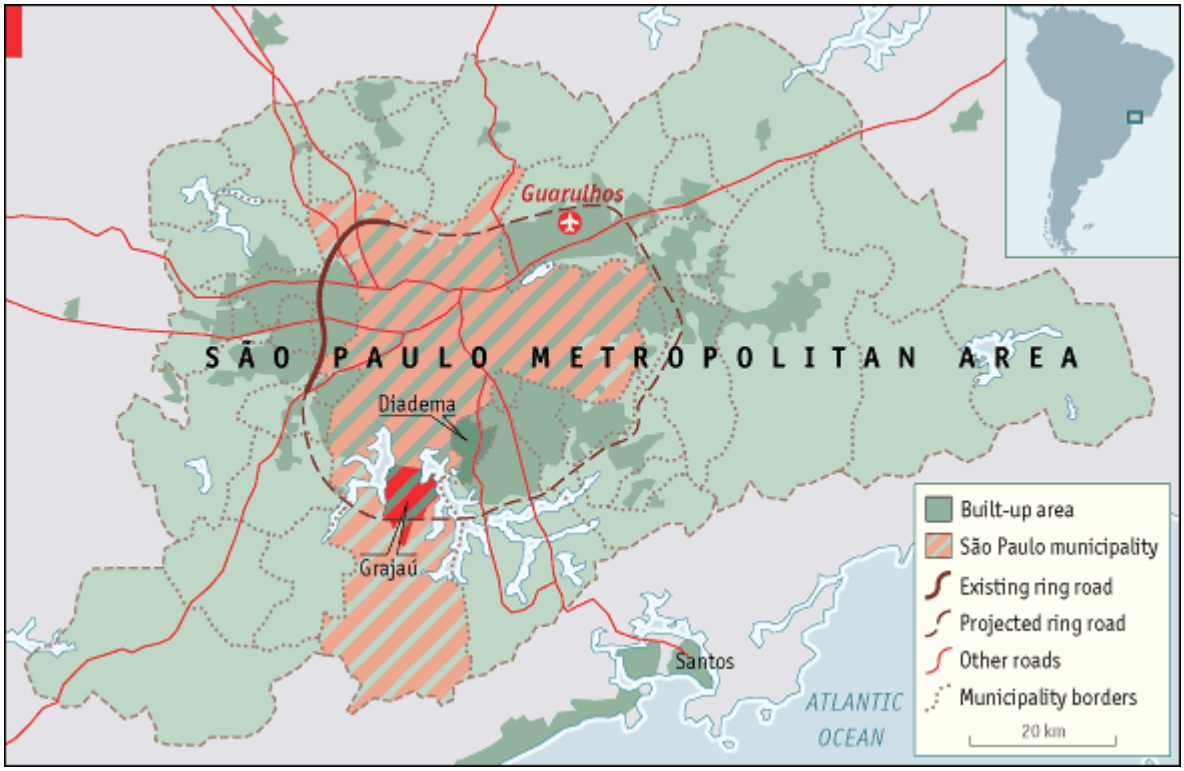
Early on, the city's leaders opted for a compact, well-appointed nucleus—and let newcomers fend for themselves in the vast periphery. In the 1920s they decided to base public transport on buses, not trains or trolleys, which meant manpower could be shipped to work from almost anywhere. Zoning in the 1970s confined tall buildings to 10% of the city's territory. Poorer *paulistanos* ended up building their own shelter, often on *loteamentos* where title is fuzzy. To settle close to reservoirs, as the residents of Grajaú did in the 1970s, was illegal. That made the land cheap but justified the city's sluggishness in providing infrastructure and services. More than a third of the city's homes are “irregular.”

São Paulo is no longer a magnet. Recession in the 1980s and an economic opening in the 1990s struck it harder than other parts of Brazil. Exposed to international competition, industry retrenched and automated, throwing formerly well-paid workers on to the streets. Drugs entered the *loteamentos* and criminals roamed beyond them, panicking *paulistanos* into armouring their cars and walling in their houses. The growth rate of the city's population slumped, from 5.6% a year during the 1950s to 0.8% since 1991. Some areas of the periphery and surrounding towns are still growing at breakneck rates, but that comes mostly from poor urban families seeking cheaper housing. To make matters worse, two successive mayors before Mrs Suplicy were accused of large-scale corruption. “The 1990s was the hell of São Paulo history,” says Gilberto Dimenstein, a journalist who writes about the city. “The worst part is over.”

That is partly because Brazil's economy is recovering. Unemployment in metropolitan São Paulo (defined broadly to include people doing odd jobs) fell from 21% in April 2004 to 17% in November. Even so, says Miguel Matteo of SEADE, a government research institute, average wages in 2004 continued an 18-year slide, partly because new service jobs pay less than extinguished manufacturing ones. Yet the city's murder rate peaked in 1999, and has since dropped by about a quarter.

Parts of the periphery have become less wretched. Most of Parque Cocaia, Mrs dos Santos's neighbourhood in Grajaú, is paved. The city provided water, electricity and schools after a “struggle” by its residents, says João Neres de Oliveira, the president of the residents' association. Its bustling high street has chain stores. Grajaú is São Paulo's third most-violent district, with a murder rate of 86 per 100,000 people in 2003. But that is 20% lower than two years before. Mrs Suplicy made it easier to get from Grajaú to the centre. Commuters can now switch buses without paying an extra fare. New express lanes for buses have cut commuting time nearly in half, to little more than an hour. Mr de Oliveira claims that the unemployment rate in Parque Cocaia is 50%. But many of the unemployed now collect a “minimum income”, funded by city, state and federal

governments. This reaches 80% of the city's poor, claims Marcio Pochmann, who was Mrs Suplicy's labour secretary.



“Social inclusion is a fundamental commitment,” proclaimed Mr Serra in his inaugural address, meaning he is not going to turn his back on the periphery. But there will be changes, especially given the city's straitened finances. He is likely to stop building Mrs Suplicy's expensive schools-cum-leisure centres aimed at giving the young something to do besides get into trouble. He wants to extend the single ticket from municipal buses to the state-run trains and the metro system. But he frets about its cost. Mr Serra will give health services a higher priority than Mrs Suplicy did. But his first concern is to get more bang from each municipal buck. One of his first acts as mayor was to announce the renegotiation of city contracts.

Redrawing the map

If Mr Serra merely pinches pennies, he will miss a chance to influence the redrawing of São Paulo's map, which is in both political and physical flux. Brazil's federal system does not provide for metropolitan government. For example, while the municipality manages the city's bus network, the state runs its trains, the metro and inter-city buses. The system links the city to satellite municipalities, but moving between these is a nightmare. This cuts people off from potential jobs. Likewise in health: federal funding goes straight to municipalities in accordance with their populations, but services are not co-ordinated. In Diadema, which borders São Paulo, half the patients in the hospital are from neighbouring municipalities, says Mário Reali, a state assemblyman. Since 30% of Diadema's budget is spent on health, that is no small matter. And so on.

Metropolitan government might make sense, but vested interests and the constitution make it unlikely. Instead, Lula's government wants “consortia” of municipalities, which would receive funds for joint projects in such areas as transport and waste management. But the São Paulo state

government, run since 1994 by the PSDB, argues that the constitution makes states responsible for regional co-ordination. The PT wants to bypass the states because it governs so few of them, says Andrea Calabi, the economic secretary of São Paulo state. Its initiative “poses a threat to how you organise government in Brazil.” But the city and the state should get along better now that the mayor and the governor belong to the same party.

The state government envisages a trio of institutions to manage the São Paulo metropolis: an advisory “development council”, composed of state and municipal representatives, which could suggest, for example, where to put schools and hospitals; a common fund to which all would contribute; and an agency to execute the council's decisions. Neighbouring municipalities, especially those run by the PT, are wary. They have “participated very little” in the state's metropolitan musings, complains Mr Reali of Diadema. And it would be hard to balance the interests of rich, powerful São Paulo with those of its smaller and poorer satellites. But such squabbles hide common aims. Marcos Campagnone, chief of the state's planning agency, wants to “reverse the spread of the periphery” partly by completing an orbital road and rail line to siphon away through-traffic and, he hopes, create a barrier to further urban sprawl. Raquel Rolnik, an official at the federal cities ministry, calls for “growing towards the centre”. Both envisage a denser, more uniform metropolis.

Mrs Suplicy's team drew up some schemes to this effect, under a 2001 law which mandates municipalities to draw up “master plans” reconciling private interests with the “social function” of urban property. São Paulo's plan, completed last year, would create new areas of low-income housing and a new fund for public works financed by selling building permits and permitting the city to expropriate abandoned land. One scheme planned by Mrs Suplicy, Bairro Novo (new neighbourhood), would house 70,000 people, including 600 low-income families, in an area of abandoned factories close to the centre and serviced by train. It would be São Paulo's first planned community, boasts Mr Wilheim, and would break (a little) the pattern of separate ghettos for rich and poor. Another project would deal a blow to the hub-and-spoke traffic model: a road between Guarulhos, the site of São Paulo's international airport, and the industrial region south of the city.

How much of this Mr Serra will continue is unclear. He has endorsed the new road but says the master plan needs revision. *Paulistanos*—not least those mouldering in the outer ring—will hope that the city's still incipient revival will strengthen under their new mayor.

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Ecuador

The survivor

Jan 27th 2005 | QUITO
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Behind a fragile power grab

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AFP

Gutiérrez, despot or dove?

JUST who is the real Lucio Gutiérrez? The army colonel who staged a coup in 2000, was elected Ecuador's president two years later on a populist platform and who last month got Congress to sack the Supreme Court and replace it with placemen? Or the moderate self-declared American ally, who has imposed fiscal discipline, is seeking to open up oil and the utilities to private investment and has promised an early referendum on the court shake-up? In other words, is he a closet authoritarian or a weak democrat?

The ousting of the court was almost certainly unconstitutional and has dented the government's democratic credentials. Civic groups protested. Business leaders complained. The former Supreme Court justices rejected the new court. And the United States Embassy somewhat tardily expressed its “concern” to the president.

Some worry that Mr Gutiérrez is trying to concentrate power in his own hands. He has allied himself with two populist parties: one headed by Abdalá Bucaram, a former president who fled to Panama in 1997 to evade corruption charges; the other led by Álvaro Noboa, Ecuador's richest man, whom Mr Gutiérrez defeated in 2002. Their votes have given the government a slim majority in Congress, which it has used to replace not just the Supreme Court but the Electoral and Constitutional Courts too. The president has also been promoting his cronies in the armed forces.

But much of the blame lies with the opposition. The left has repeatedly tried to topple Mr Gutiérrez through street protests. In November, the conservative Social Christian Party, which controlled the ousted Supreme Court, led a specious attempt to impeach him. It was this which obliged Mr Gutiérrez to cobble together his current alliance. The pressure to change the court came more from Mr Bucaram than the president.

Most Ecuadoreans appear indifferent to its fate. Polls show Mr Gutiérrez's popularity rising from the low teens last autumn to over 20%. His new allies may help him complete his four-year term—no mean feat in a country which has seen six presidents since 1996. But can he do more than merely survive? The government hopes to use its new majority to push through reforms of oil, electricity and social security, previously blocked in Congress. It also wants to take advantage of booming oil revenues to issue bonds for the first time since Ecuador defaulted on some of its debts in 1999.

But Mr Gutiérrez will have to move quickly. His majority is fragile. The revised Supreme Court is likely to be a point of friction. Its first president has already resigned. Mr Bucaram's party will want the court to drop the charges against their absent leader—to which Mr Noboa is sure to object. And both men are likely to resist Mr Gutiérrez's plan for a referendum on the court's shake-up. In Ecuador, no political alliances are for ever.

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Argentina

Under-utilised

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Troubled privatised utilities are threatened with state control

ALTHOUGH President Néstor Kirchner appeared all smiles as he wrapped up a state visit to France last weekend, his grip-and-grin in the Hotel Meurice lobby in Paris could not remove what President Jacques Chirac called “a little stone in the shoe”—Argentina's stalled negotiations with Aguas Argentinas, a water provider serving 6.5m people in greater Buenos Aires, which is 40%-owned by a French conglomerate, Suez.

Like all Argentina's privatised utilities, Aguas Argentinas saw its dollar fees converted to devalued pesos (or “pesified”) and frozen by a government emergency law during the default crisis of 2001-02. Although the government initially promised a renegotiation within four months, it has taken three years. Since that crisis, rates have not budged despite a rise in prices of over 50% and a 70% currency devaluation.

Now that Argentina has begun to tackle the biggest consequence of the crisis—the restructuring of $81 billion in non-performing debt, the utilities are moving back up the agenda. But given the current climate of negotiations, it seems unlikely that utility investors will have much more reason to be optimistic than Argentina's creditors, who are barely getting back 30 cents on each dollar invested.

The state and Aguas remain far apart. After fining the utility $680,000 for recent cuts in drinking water, the government is calling for $136m in new investment. But Aguas, whose debts already total $700m, is loth to part with further capital. It is demanding a 60% rate increase; the government is offering just 16%, plus a $50m capital investment grant. Aguas says this is not enough. Yet with congressional elections looming this autumn, the government is reluctant to offer any more to Aguas or the other foreign-owned utilities.

Its hand may yet be forced. The utilities have lodged claims with the International Centre for Settlement of Investment Disputes, the World Bank's arbitration body, demanding some $16 billion in compensation from the state for “pesification” and the rate freeze. A first decision is expected by March. If the ruling goes against the government, it may decide to raise its offer substantially to ward off further claims.

But to undertake new investment, the utilities need assurance of reliable future income from much higher rates—which Argentina might not convincingly be able to offer even if it wanted to. As France's deputy foreign minister, Renaud Muselier, said, French firms interested in further investments in Argentina need “clear rules of the game in the economic field”.

The government, however, seems to be moving in the opposite direction. Its recent talks with Aguas have focused on restructuring the enterprise into a public-private partnership. A bill before Congress would give the state sweeping new powers over the utilities, enabling it to modify

contracts almost at will. Alberto Fernández, Mr Kirchner's chief of staff, has even hinted at a possible complete renationalisation of Aguas. While this might boost support for the president's Peronist party in the coming legislative elections, Argentina's dismal track record of infrastructure investments by state-owned enterprises should give pause to voters concerned about the quality of their utility services.

Whatever the government decides, its vaunted economic recovery will founder if it cannot secure the environment for capital. “We can't be reinventing the country every ten years,” says Héctor Huici, a lawyer involved in utility arbitration cases. “We need to learn that stability and honouring contracts are important and will benefit us in the long run.”

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China

No sign of a landing

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Reuters

China's economy continues to grow at breakneck speed

“OFFICIALS produce statistics; statistics produce officials,” goes a neat Chinese saying, referring to the propensity of China's cadres to use falsified data to seek promotion. This week, the National Bureau of Statistics (NBS) declared that China's economy grew by 9.5% last year, its fastest clip in eight years. A few years ago, people might have suspected that this figure was deliberately inflated. The reality, though, is almost certainly the opposite. While officials still love to manipulate figures, it is likely that the government's estimate of GDP growth is an honestly produced one and that its campaign to prevent the economy from overheating still has a long way to go.

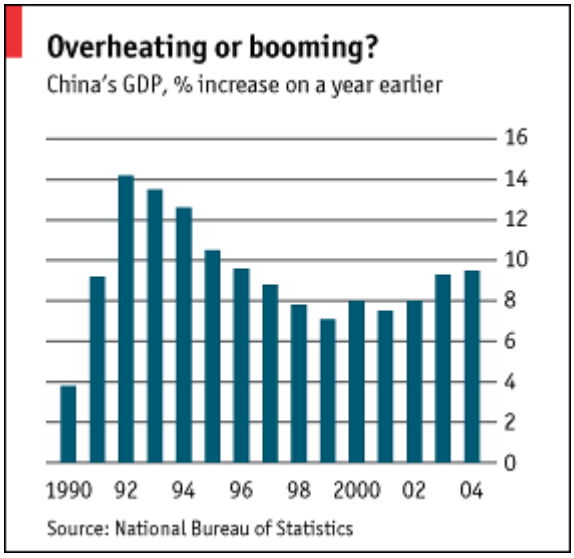
Even economists in the government's own think-tanks had been predicting recently that GDP growth last year would be the same or slightly less than the 9.3% recorded in 2003 (albeit still far faster than the 7% target proposed by the prime minister, Wen Jiabao, in March). Last October, a senior government economist forecast that growth in the fourth quarter would be around 8.6%. In fact, according to the NBS, it was 9.5%, a significant upturn from the third quarter's 9.1%.

The bureau put a brave face on the figures, attributing the quickened pace of growth at the end of last year to stronger than expected performances in agriculture and services—the parts of the economy China still wants to boost. The NBS's director, Li Deshui, said the growth of investment in fixed assets, such as factories, equipment, property and infrastructure, had “clearly come under control”. Such investment grew by 25.8%, 1.9 points below 2003. And its rate of growth did indeed slow markedly during 2004 from a roaring 53% in the first two months. But December's rate was still 21.3%.

Encouragingly, the government's cooling measures, including lending curbs and an interest-rate increase, do not appear to have affected consumer spending. Growth of retail sales of consumer goods remained strong during the year, with December's sales 14.5% higher than a year earlier. This offers some hope that investment can be curbed without a sharp slowdown. But many economists expect the government to have to make further interest-rate adjustments in the coming year, particularly if rising raw-material prices revive concerns about inflation (the consumer-price index rose 3.9% in 2004, up from 1.2% in the previous year, but with signs of easing towards the year's end).

The government's GDP figures, however, are not set in stone. Gone are the days when China would announce a GDP growth rate at the end of the year and never look back on it. Since 2003, it has been changing its GDP reporting methods to conform more to international standards. The 9.3% growth rate for 2003, announced last October, was a revision of an initial estimate of 9.1% given the previous January. From this year, provincial GDP figures, which until now have been unilaterally declared by the provinces themselves and have often shown signs of official manipulation, will be verified and announced by the NBS.

The GDP figure for 2004 could require significant adjustment following China's first economic census, which was launched this month and is intended to become a five-yearly exercise. China has conducted censuses before of certain parts of its economy. But this one covers all economic activity, except for agriculture.



Most important, this census is the first to cover the booming construction industry, and the first since 1993 of the services sector. Both construction and services have grown enormously in recent years and have become big engines of employment growth. In 1995, in light of findings from the first service-sector census, China (in a break from tradition) revised its GDP growth figure for the previous year from 11.8% to 12.6%.

According to the latest NBS figures, service industries last year accounted for nearly 32% of GDP, only about the same as ten years ago. In November, *21st Century Business Herald*, a state-owned newspaper, quoted an unnamed NBS official as saying that this figure was “clearly lower than reality”. Li Qiang, the NBS's chief statistician, says the census could also show that output by individually- or family-run firms has been understated, with many of them escaping other forms of data collection because they are not officially registered (the census is supposed to cover all businesses, whether registered or not).

Mr Li predicts that by the time the forms are collected at the end of March, some 90% of Chinese businesses will have responded to the census—a rate higher, he says, than is found in America. But how accurate will the data be? Although streets are festooned with billboards and red banners calling on citizens to comply with the census, Mr Li admits that some businesses, particularly smaller ones, are unwilling to reveal data for fear they might be leaked to the tax authorities (regulations supposedly prohibit the NBS from doing this). During trial runs last year, cases emerged of local officials tampering with data. In one district, census figures were altered to make them match local records after it was found that output from large industrial enterprises was 90% higher than these records had shown.

The first results from the census are due in August, and complete data by the middle of next year. Whatever they reveal, it is unlikely to be that China has been wildly overstating its GDP growth figures, as some economists believe it did in the late 1990s in the wake of the Asian financial crisis. But neither is it likely that they will dispel perennial doubts about what is really going on in China's economy.

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South Korea

Lame duck walking

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Time is running out for President Roh

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THE constitution limits South Korea's presidents to a single, five-year term. Intended to discourage dictators, this has also meant that the head of state is relegated to the status of lame duck long before his official term ends. With almost two years already behind him, Roh Moo-hyun now has precious little time left to establish a legacy: accordingly, he seems anxious to reach an accommodation with the political opponents who have made his presidency so painful up till now.

It has been a tumultuous two years. Mr Roh's policies and pronouncements have exacerbated ideological and generational divisions and, together with his freewheeling style, have made him many enemies. Bitter clashes between the opposition conservative Grand National Party and Mr Roh's ruling liberal Uri party over a number of controversial reform measures have hampered the administration, culminating in last year's failed attempt by the opposition to impeach the president.

The signs are that the president is now prepared to pursue more co-operative relations with big business, the media and his political opponents. For instance, the recent appointment of the establishment figure of Hong Seok-hyun, chairman of an influential daily newspaper, *Joong-Ang*, as the new ambassador to Washington looks like an attempt to woo a powerful ally.

An extended period of calm in the political arena cannot come too soon for South Koreans, who have grown weary of the constant ideological battles. They are more worried about their standard of living than doctrinal disputes and have welcomed Mr Roh's promise, in his new year address, to make the flagging economy his priority.

The human-rights lawyer-turned-president has proved a disappointment to many, to his supporters perhaps most of all. Mr Roh has largely squandered the high approval ratings he enjoyed when he first entered office. Topping 80% when he took office, they sank to 20-30% last year.

For his political reforms, Mr Roh can claim some credit; although his investigation into collusion between big business and politicians revealed a murky presidential record. But in the economic, social and foreign policy fields, the president's impact has been limited. “He is a man of his time, rather than shaping his time. He has achieved less than he could have done,” says Lim Won-hyuk of the Korea Development Institute.

The ruling Uri party holds 150 out of 299 parliament seats, and its wafer-thin majority is set to evaporate in forthcoming by-elections. Without minority party support, Mr Roh's path to lame duckery will be a rapid one.

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Japan

An empress regnant?

Jan 27th 2005 | TOKYO
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Japan considers letting women take the throne

IN JAPAN, social progress often comes in baby steps. So it is fitting that a prominent decision about women's equality will involve Japan's most famous baby: three-year-old Princess Aiko. On January 25th, a ten-member government-appointed panel met for the first time to discuss whether women should be made eligible for the imperial throne. If the law is revised, Princess Aiko might one day take a very big step indeed.

Most Japanese like the idea. In a recent poll by the *Yomiuri Shimbun*, a big daily, 79% said that women should be allowed to take the throne. Less than 4% were opposed. In 1975, only 32% were in favour. Perhaps conservatism and sexism are fading faster in Japan than people thought. But equality is not the only factor. Popular support for female succession also reflects the way the government has sold the issue, as a step to bolster the stability of the Chrysanthemum Throne: something dear to conservatives' hearts as well.

The imperial family will not run out of male heirs for a while yet. Crown Prince Naruhito is only 44, and his brother, Prince Akishino, is five years younger. But because no males have been born since them, and existing law strips women of their royal status when they marry commoners, the imperial family could face a succession crisis one day under current law. That is why so much attention has focused on Princess Aiko, the only child of the crown prince and princess.

Many Japanese feel sympathy for Crown Princess Masako, a 41-year-old, well-educated former diplomat who has had a hard time coping with imperial life. For years after her marriage to the crown prince, single-minded officials of the Imperial Household Agency pressured her to produce a male heir. The birth of her daughter in December 2001 captivated the nation. But that happy announcement has been followed by tough times for the crown princess.

Last summer, the Imperial Household Agency acknowledged that she was being treated for anxiety and depression. A few months earlier, her husband had shocked the public by blaming unnamed people for trying “to deny her career and personality”. Some Japanese assume that her unhappiness stems from ongoing pressure by imperial-household officials to bear a son. Making Princess Aiko eligible for the throne would remove any doubts over succession, and relieve any pressure on her mother.

The prime minister, Junichiro Koizumi, has other reasons for wanting to move quickly. He has already been one of Japan's longest-serving post-war prime ministers, and the economy has turned around impressively since he took office in April 2001. But his Liberal Democratic Party (LDP) imposes term limits, and his stint as its leader is due to end in September 2006. Many of the projects Mr Koizumi has pursued to cement his legacy will take much longer to reach fruition.

Privatising the postal service, his pet project, will take more than a decade. Japan is pressing the

United Nations for a permanent seat on the Security Council, but that is no overnight task. And although the LDP will propose some constitutional revisions later this year—perhaps tweaking Japan's pacifist restrictions in the process—enacting any changes will take much longer. That leaves a territorial dispute with Russia and the “stability” of the throne as Mr Koizumi's best bets for achieving something popular.

The panel will have much to discuss. It could, for example, choose to make men and women equal in the imperial line, thus giving priority to Princess Aiko over her uncle, Prince Akishino. Or it could opt for a system like Britain's, in which a woman can take the throne, but only if the monarch has no male issue. Hopefully, the panel's deliberations will spark some debate over the broader role of women in Japan. May Princess Aiko grow up in a country with more women as accomplished as her mother.

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Australia

Third time lucky?

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From The Economist print edition

An old new leader for Labor

Get article background

THE 87 members of Australia's opposition Labor Party looked set to face a one-horse race at their meeting on January 28th to elect their third leader in just over three years. Kim Beazley, who led Labor from 1996 to 2001, was left as the only candidate for the job after two rival contenders, Kevin Rudd and Julia Gillard, announced their withdrawal. Both conceded they had been unable to muster sufficient support among their parliamentary colleagues to challenge Mr Beazley. When Miss Gillard pulled out of the race on January 26th, she described Mr Beazley as “a big man with a big heart and a big commitment to Labor”, and offered her “unfettered loyalty” to him as leader.

Barring any unforeseen glitches, the path was cleared for Mr Beazley to resume the Labor leadership at one of the lowest points in the party's 114-year history. Labor is still reeling from the shock of its fourth successive defeat last October by the conservative coalition government led by John Howard. On January 18th, a second shock followed when Mark Latham, who had led Labor for only 13 months, resigned as leader and from parliament.

At only 43, and with a fiery, unconventional streak, Mr Latham had promised to lift Labor out of its electoral doldrums. But the debacle of his short tenure probably explained why the prospect of Mr Beazley's steady hand returning to the helm held more allure for his colleagues than the temptation of installing another young Turk. Miss Gillard, 43, and Mr Rudd, 47, both bright and possible future leaders, have been in parliament for only six years; Mr Beazley, 56, has been there for 24 years, and was a minister and deputy prime minister during 13 of them. True, he has lost two elections to Mr Howard, but not nearly as badly as Mr Latham did.

A tough year lies ahead. In July, the government will take control for the first time of the Senate (there is a long delay between its election and its installation), giving it what Mr Beazley called “a position of absolutely unprecedented power”. And Mr Howard's personal ratings have just hit 67%. For Mr Rudd and Miss Gillard, discretion may have proved the better part of valour.

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Myanmar

A very special region

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From The Economist print edition

Sex and drugs in the Shan state

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WITH its hill-tribe villages and opium warlords, the Shan state of northern Myanmar is among the least developed regions of Asia. But as you approach the Chinese border, the landscape is suddenly transformed. Like a hallucination, a garish town of concrete, neon, casinos and night-clubs appears. “Welcome to Mongla Special Region No. 4”, a billboard proclaims.

Remote and once dirt-poor Mongla has been reborn as a tourist destination, a process that started in 1989, when Myanmar's army reached a ceasefire and autonomy deal with the Shan. The local warlord, a Shan Chinese named Sai Leun (also known as Lin Mingxian), built Mongla with an unorthodox mixture of opium profits and technical aid from China's neighbouring province of Yunnan.

Around 350,000 Chinese tourists visit every year to gamble, frequent the massage parlours, and

perhaps take in a Thai transvestite show. Lin Mingxian, as he was born, has clearly come a long way from his days as a Red Guard during the Cultural Revolution in the 1960s. Mongla's authorities earned $9.6m from tourism in 2002—and it is entirely possible that they concealed some of their income.

But is it still Myanmar? Apart from the fluttering of Myanmar's flag by the side of government buildings, there is little to suggest any connection with the rest of the country. Myanmar's kyat are scorned; only Chinese yuan are acceptable. The street signs, the language, and most government employees are Chinese, though many are ethnic Chinese born in Shan state, as well as Yunnanese immigrants.

Opium poppies used to flourish openly in the hills around Mongla, but in 1997 Sai Leun declared his fief an “opium-free zone”. Chinese advisers were brought in to develop alternative crops, and Sai Leun promoted his new image as an anti-drugs campaigner—he is chairman of the Mongla Action Committee on Narcotics—by opening an opium museum to educate people about the evils of drugs. It strangely neglects to mention that until 2000, the name Lin Mingxian featured prominently on America's most-wanted list for major heroin traffickers.

Mongla's carefree existence may be threatened. For one thing, China is disappointed that despite some efforts at crop substitution in Mongla, there has been no real impact on the flow of heroin into China, and the growing tide of addiction in Yunnan.

And in October last year General Khin Nyunt, who as Myanmar's prime minister and intelligence chief, brokered the 1989 ceasefire deal, and was close to Sai Leun and other figures in the Golden Triangle drug trade, was ousted from the troika that runs Myanmar. The Shan, as well as other ethnic minorities, like the Wa and the Kachin, who reached similar deals with Khin Nyunt, fear that Myanmar's re-ordered junta may now renege on the agreements. Thousands of Wa soldiers are said to be mobilising for a possible fight. Caught between the *junta*, Chinese drug warlords, and the new casino capitalists, there seems little hope of development for the ordinary people of Shan state.

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Nepal

School's out

Jan 27th 2005 | KATMANDU
From The Economist print edition

The education system is a casualty of Nepal's Maoist insurgency

RUPA PUN, a teacher in Nepal's Baglung district, is not at school these days. She was taken to Katmandu for treatment after being beaten up and tortured by Maoist rebels last November. They pummelled her with their rifle butts, walked over her, gave her electric shocks and drilled holes through her shins. Her crime was association with a left-wing group that is campaigning against the “social fascism” of the Maoists. But, in general, her profession is in the front-line of Nepal's dirty war.

With the exception of the teachers and some health-care workers, representatives of the central government have withdrawn from most of Nepal's villages. Almost all police stations have been abandoned, and the army, ensconced in district headquarters, is often seen as a menace as dreaded as the Maoists themselves. Many schools are strategically placed on the top of hills; teachers, often recruited through systems of patronage, have traditionally seen part of their role as political.

They now find themselves prey to the demands of both sides in the war: the Maoists want them to pay “taxes”, and to indoctrinate their charges. The army then suspects them of collaboration. According to the Informal Sector Service Centre, a human-rights group, at least 126 of the more than 10,500 people killed in the nine-year war have been teachers, two-fifths of them killed by the state.

Hundreds of others have fled. Pradeep Keshi is one of more than 200 who have taken refuge in Katmandu. His tale is one of steadily mounting Maoist demands: for money, for his house and land, for his joining their “programme” and teaching it to his charges. Of the 16 teachers in his school in Okalganga district, with 498 students, eight have left. Those who have stayed, he says, have had to “adjust”, pay Maoist taxes, and escort their pupils to Maoist training camps.

The impact of all of this on Nepal's future is incalculable. UNICEF, the United Nations Children's Fund, estimates that schools, once open between 180 and 200 days a year—the shortest period in South Asia—are now functioning only 100 days a year. In one district, Dailekh, where women have led an uprising against Maoist exactions, teachers are on strike and 300 schools are shut.

Both sides exploit children. The Maoists employ them as soldiers, informers, messengers, porters and mine-layers. The national army winks at under-age recruitment since it faces a shortage of young men. Many have fled the poverty that has nurtured the Maoists to seek work in Katmandu or abroad.

Nepal's adult literacy rate, at just 44%, is already among the lowest in the region. A generation is now growing up for whom, in the words of Suomi Sakai, UNICEF's representative, school is “a place of fear, a place of violence”. The implications of this for the country's future are so bleak that

it seems it should be in everybody's interests to change it. As Ms Sakai points out, Maoists have children too.

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Indonesia

Finnishing the war

Jan 27th 2005
From The Economist print edition

A new round of talks on the war in devastated Aceh

Get article background

AT SOME point in the next few days, somewhere in Finland, representatives of the Indonesian government and the Free Aceh Movement will meet to discuss a ceasefire. The mediators who engineered the meeting, led by a former Finnish president, Martti Ahtisaari, are keeping mum about the details. But they must hope that the devastation wrought by last month's tsunami will instil a sense of urgency and a spirit of compromise in the negotiators. Both were lacking the last time the government and the rebels, known by their Indonesian acronym, GAM, met up.

Aceh, a province of some 4m people at Indonesia's north-western tip, has a long history of rebellion, first against Dutch colonialists and then the Indonesian government. The latest uprising started in 1976. Suharto, Indonesia's strongman at the time, gave full rein to the army, whose ill-disciplined and abusive conduct alienated many Acehnese.

After Mr Suharto's fall, the authorities took a more conciliatory approach. In 2001, parliament passed a law granting Aceh wide-ranging autonomy, and a big share of revenues from the province's oil and gas fields. The government also started negotiations on a peace deal with GAM. But many generals viewed the talks as a form of capitulation. When GAM balked at a proposal to place its weapons in depots for outsiders to inspect, Indonesia called off the talks and put Aceh under martial law.

Since then, the army claims to have killed over 2,500 rebels and to have locked up 4,000 more. GAM, however, insists that it is still going strong, and that the army's victims are mostly innocent civilians. The reality is probably in-between: the army has the guerrillas on the defensive, but will find it hard to eradicate them altogether. In 2003, it estimated GAM's strength at 5,000 men, and said it would win in six months.

Susilo Bambang Yudhoyono, Indonesia's president, has often promised to bring peace to Aceh, and has proposed an amnesty for penitent rebels. But some generals have been undermining the government's overtures with more belligerent talk. GAM's leaders, who have been living in exile in Sweden for decades, tend to take a harder line than the hard-pressed rank and file. They continue to speak of independence, at least as a rhetorical goal—something the government will not countenance. The worry is that both sides appear to be negotiating more for public relations than through conviction.

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India

Inside the slums

Jan 27th 2005 | MUMBAI
From The Economist print edition

Light in the darkness

AFP

The way out of Dharavi

FLYING into Mumbai airport, many visitors' first view of India is of a mass of corrugated-roofed slums clustered on hillsides around the end of the main runway. That is scarcely a viable image for a country's commercial capital that has set Shanghai as its role model, and it is a problem that has defied government action for over 30 years. But hidden in these and Mumbai's other sprawling slums is a thriving entrepreneurial spirit that has spawned small businesses ranging from pottery to leather goods, and that is also now beginning to support formal property development.

In Dharavi, one of Asia's largest slums, covering 220 hectares (530 acres) near the airport, some 100,000 people produce goods worth over $500m a year. Alleyways a few feet wide lead to bakeries, metal workshops and sheds that recycle discarded plastic goods ranging from medical syringes to telephones. Lorries crammed with buffalo, goat and other skins collected from abattoirs push through narrow lanes to grimy tanneries. Nearby, workers in a series of tiny workshops spray-paint, cut and press strips and sheets of leather and vinyl that eventually finish up as cheap wallets and bags plus, in some cases, upmarket luggage (often fake international brands). Few of the workers earn more than Rs100-200 ($2-4) a day, and families often live in overcrowded lofts over the workshops.

More than 800 homes are involved in pottery, moulding items such as traditional clay water jugs and flower pots on potters' wheels for sale inside and outside Dharavi. Their kilns burn wood and other polluting garbage, including tyres. Metalworking includes casting items such as brass belt-buckles in small unventilated rooms. In another workshop, the buckles are electroplated with nickel because, say the workers, a nickel finish does not need polishing and is more popular.

Some of these businesses are owned and operated by members of a single family. In others, workers are employed by an upwardly-mobile owner who lives elsewhere. Abdul Hassan, who was born in Dharavi, runs a plating workshop with his brother and 12 workers. The brothers each take home about Rs4,000 a month. Abdul has bought a flat just outside Dharavi and is paying for his two children's education, in the hope that they will become doctors or engineers.

Next month, Mumbai's Slum Rehabilitation Authority plans to begin drawing up a list of developers who will bid to transform Dharavi, turning this hotch-potch of unregulated homes and mini-factories into a $1.2 billion showpiece over seven years. Companies like Mitsubishi of Japan and parts of India's Godrej and Reliance business groups are interested.

Local residents and non-governmental organisations are sceptical about the motives. Dharavi is on a prime location adjacent to a big nature park and a mile or so from the city's new Bandra-Kurla business district, as well as being near the airport. “We think it's a way to appear to do something for the poor while really gentrifying the area,” says Sheila Patel, director of SPARC, a voluntary organisation that has begun redeveloping small sites on a piecemeal basis in collaboration with residents. But Mukesh Mehta, an architect who has drawn up the scheme for the government, insists that existing residents and businesses will all be housed. The redevelopment of Dharavi is part of an attempt to give Mumbai a dramatic make-over, with a $40-billion ten-year development programme, based on a report by McKinsey, a consulting firm. To be financed mainly by the private sector, the remit is for “a world-class city with a vibrant economy and globally comparable quality of life”, reversing a slowdown over the past decade.

Despite the many businesses, it will be tough going. Approximately half of the city's 13m population (part of a 20m conurbation) lives in the slums—areas of unregulated, poor-quality structures, usually built of mud or brick and asbestos sheets, with no sanitation. Governments have rarely dared try to evict the occupants of the slums because they are condemned for destroying the homes of the poor, though about 70,000 relatively new dwellings have been bulldozed in the past month.

Using a scheme that allows a developer to cover some of his costs by selling any excess property, organisations such as SPARC (backed in two projects by international aid agencies and banks) have built blocks of 21 sq m (225 sq ft) flats that dramatically improve living conditions. But progress is slow, which has opened the way for Mr Mehta's overall redevelopment. Many residents are sceptical. “For years people keep promising to redevelop but nothing happens,” says Jagmohan Bhattia, who has four employees pulverising old plastic crates, a job he has been doing in the middle of Dharavi for 15 years. But for some, there is hope.

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Correction: education in Japan

Jan 27th 2005
From The Economist print edition

In an article about education in Japan last week, we used a photograph of a Chinese school in place of a Japanese one (in the print edition only). We were misled by a picture agency's caption error: but we should at least have spotted the absence of *kana* on the blackboard. *Sumimasen*.

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Nigeria

Democracy and its discontents

Jan 27th 2005 | ABUJA
From The Economist print edition

AFP

The unenviable task of governing Africa's most populous country

Get article background

THE street names haven't changed. Some of the grandest thoroughfares in Abuja, the Nigerian capital, commemorate former military dictators. But Nigeria has been a civilian democracy for nearly six years now, and its people show no appetite for a return to the bad old days of bemedalled presidents. Why, then, are so many prominent Nigerians so gloomy?

Wole Soyinka, a Nobel laureate for literature, says that the elected regime of President Olusegun Obasanjo is so unpopular that it is headed for collapse. Even more worryingly for Mr Obasanjo, the head of his own party made a similar prediction last month, drawing a parallel between the current regime and a notoriously corrupt one that was overthrown in a coup in 1983.

Some parts of the country are indeed looking unstable. The army is barely keeping a lid on mayhem in the oil-producing south-east, where thugs fighting over the spoils of political office (among other things) kill about 1,000 people each year. Last week, the government banned the sale of newspapers carrying stories about the region's largest separatist movement, arguing that such reports stir unrest.

In the south-eastern state of Anambra, government has ground more or less to a halt because of a quarrel between the state governor, Chris Ngige, and his political “godfather”. The tycoon who bankrolled Mr Ngige's election campaign is reportedly upset that, having been elected, Mr Ngige

has not given him enough say in how the state is run.

For some reason, the police declined to intervene when, in November, thugs burned down the main government buildings in the state capital of Anambra and shot at the governor. This local crisis reflects badly on Mr Obasanjo, not least because the brother of Mr Ngige's “godfather” is a senior presidential adviser.

As if all this were not enough, Mr Obasanjo's opponents continue to challenge the results of the elections in 2003. Muhammadu Buhari, a former military dictator who was Mr Obasanjo's chief rival in the presidential poll, claims that there was serious rigging in 16 of the country's 36 states, including Anambra and Ogun, Mr Obasanjo's home state. Mr Buhari is suing to have the results overturned. Lower courts having rejected his suit, he is now taking it to the Supreme Court.

Mr Obasanjo's most ambitious promise, when he assumed office, was that he would fight the corruption that has kept Nigeria poor. To this end, he has appointed clever and energetic young technocrats to a number of key posts. The much-admired finance minister, for example, is struggling bravely to make public accounts more transparent, and to push a “fiscal responsibility act” through parliament.

By some accounts, graft has indeed retreated a bit. The anti-corruption chief, Nuhu Ribadu, went so far as to claim last month that whereas 70% of the country's oil revenues were being stolen or wasted two years ago, now only 40% were. He argued that central government was now much cleaner, but that certain state governors were still filching with gusto.

Whether or not Mr Ribadu's estimates are to be believed, his gripe about the states is justified. State governments raise very little cash themselves, but rely instead on oil money from the central pot. They swallow about half of this, spend it opaquely and howl at any attempt to impose fiscal discipline. The finance minister is trying to save some of the windfall from high global oil prices against the time when prices fall again; the government of Abia state claims that this is illegal and is suing for its share of the rainy-day fund.

Nigerians largely support the anti-corruption campaign, but some worry that Mr Obasanjo is too preoccupied with other matters to see it through. What is more, since he is barred from standing for re-election when his term ends in 2007, his power is sure to wane as that date nears.

His vice-president, Atiku Abubakar, would like to succeed him. Observers doubt that he would grapple effectively with corruption. The ruling party is split between the two men's supporters; the party boss who warned that the government was headed for collapse (and then resigned) is one of Mr Abubakar's allies.

Other contenders include some of the ex-dictators honoured on Abuja's street signs. That is a grim prospect. Earlier this month, a long-suppressed official report into abuses under military rule was leaked. It accused three ex-dictators of responsibility for unlawful killings, and recommended that none should be allowed to run for president again. One or two of them, however, probably will.

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Kenya

Riven over a river

Jan 27th 2005 | EWASO ONKIDONG
From The Economist print edition

Tempers flare in the dry season

Get article background

"IT WAS a great war. We killed many people with our spears and bows and arrows," boasted a young Masai warrior with pleated hair, adding that the battle he had just returned from would "go down in history". He was fighting over the Ewaso Kedong river, the only water source for some 30,000 Masai and their cattle. The Masai claim that a well-connected businessman from the Kikuyu tribe (the one to which Kenya's president, Mwai Kibaki, belongs) is siphoning off the water for his flower farm.

This weekend, the Masai struck back. Knowing the businessman's farm was well-guarded, they instead attacked a nearby Kikuyu village, burning houses and killing between 10 and 30 people, including a pregnant woman who was disembowelled before she died. Local Kikuyu retaliated by erecting barricades along a busy tourist road, hauling Masai passengers off buses and slitting their throats.

A rash of tribal fighting has erupted in parts of Kenya over the past two weeks. In the north, close to the lawless Somali border, 30 people were killed and 30,000 forced to flee as the Garre and Murule clans fought. Kenya's inhospitable northern regions are prone to violence, especially at this time of year when the wells are dry and good pasture is scarce. With drought predicted this year, tempers could flare still further.

Kenya is not on the verge of civil war, but peace should not be taken for granted either. In the mid-1990s, when Daniel arap Moi was president, several hundred people were killed in politically-motivated tribal clashes. This weekend's fighting has shown how easily things can escalate, and how easily passions can be manipulated.

The ruling coalition is multi-ethnic, but widely seen as Kikuyu-dominated. Other tribes worry that Kikuyu politicians are favouring their own with jobs and permits, for example, to drain water from a river. This causes trouble. Some hotheaded MPs have begun to rally their supporters by stirring up tribal tensions.

Some of their less-educated constituents need little prodding. Around the Ewaso Kedong river, the better-educated Masai favoured negotiations. Chris ole Pareiyo, who sells a cow a month to pay for a correspondence course, which he bashes out on an old typewriter, urged his fellow Masai to talk to the Kikuyu. "But they preferred to fight," he says.

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The Palestinians

The calm before the calm?

Jan 27th 2005 | GAZA AND RAMALLAH
From The Economist print edition

A ceasefire, perhaps. And the militants want to join mainstream politics

Reuters

A ceasefire on the horizon?

Get article background

IT IS hard to imagine Hassan, a jolly, tubby Palestinian soldier at a checkpoint in the northern Gaza strip, sticking his gun in someone's face; and he wouldn't, he says, if that someone were a militant carrying a home-made Qassam rocket intended for one of the Israeli towns nearby. “I would try to convince him that it is not for the good of the Palestinian people,” smiles Hassan. And if that fails? “Then I will tell him to get the hell away from my patch and launch it from somewhere else. I can't shoot at my own people.”

This week 3,500-odd Palestinian troops were deployed along the Gaza strip's border with Israel, at points chosen to keep would-be Qassam-launchers further from Israeli targets than their 7km (4-mile) range. Israel was pleasantly surprised. Mahmoud Abbas (aka Abu Mazen), the newly-elected Palestinian president, acted fast and decisively after Israel—before he was even sworn in—suspended talks and threatened to retaliate, in Gaza, for a suicide attack at a border crossing.

This week, after Mr Abbas had spent five days huddled with militant groups in the strip, his officials were hinting that a *hudna* (ceasefire), like the one that held for nearly two months in 2003, was close at hand. And Israel resumed contacts.

These are hopeful signs. But to expect too much of either the Palestinian troops or the ceasefire would be to miss the point. Though they have been training for when (and if) Israel pulls out of Gaza later this year, the troops remain woefully under-powered (no weapons bigger than a Kalashnikov rifle, no transport tougher than small armoured cars, under the terms of the Oslo

accord with Israel) and underpaid (Hassan earns 1,070 shekels, or roughly $250, a month).

Meanwhile, after over four years of *intifada* the militants have grown both tougher and more popular, as the reluctance of soldiers like Hassan suggests. General Nizar Ammar, the security forces' head of planning, has no illusions. “The Palestinian Authority can no longer stop this Islamic current by military means,” he says. “These organisations used to be weak, but now they are among the mainstream on the Palestinian street.”

Meanwhile, ask spokesmen for the militants about *hudna*, and they reply that for now they are offering only *tahde'a* (calm) . A *hudna*, says Abu Ameer of the Popular Resistance Committees (an Islamist group linked to the ruling party, Fatah), will depend not on Mr Abbas, but on Israel. Before his group would consider a ceasefire, he says, Israel would have to pull its troops back to where they were before the *intifada*, free prisoners, stop assassinating militant leaders (which Israel this week said it would do) and stop demolishing Palestinian homes. Other militant groups, such as Hamas (the main Islamist party) and the al-Aqsa Martyrs' Brigades (a secular Fatah offshoot), make similar demands. So do some moderates, such as Ahmad Ghunaim, one of the younger Fatah leaders.

For all of them, unlike (outwardly at least) Mr Abbas himself, a truce with Israel is not the first priority, simply because they do not trust it to keep one. Rather, they say, top of the agenda in the talks with Mr Abbas were Palestinian institutional reform, accountability, law and order—and a new political deal.

That reflects the quiet seismic shift in Palestinian politics that has been going on since Yasser Arafat's death last November. With him died the monopoly on power both inside Fatah, where a committee will have to approve the new cabinet, and outside it, where groups such as Hamas see a chance to capitalise on their popularity. “They want to participate in decision-making, elections and maybe even in the coming government,” says Hani al-Masri, a political analyst in Ramallah.

Arafat would have been appalled. But for Fatah's new leaders, Hamas, which could take many seats in upcoming local and legislative elections, is too powerful to ignore. “We have to encourage them to be part of the PLO,” says Mr Ghunaim. The militants are gradually becoming less radical; giving them a bigger political role, he argues, will accelerate that mutation. A Hamas document, aired last week, for the first time recognises Israel's 1967 borders.

General Ammar concurs: bringing the factions into the fold is essential to getting a truce and preventing “a vicious circle of violence”. Will Israel be convinced, and continue making concessions to set off a virtuous circle of *tahde'a* instead?

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Corruption in South Africa

Parliamentary padding

Jan 27th 2005 | JOHANNESBURG
From The Economist print edition

Lawmakers are not above the law

BY SOME countries' standards, a 17m rand ($2.8m) corruption scandal is no big deal. But the South African MPs who allegedly fiddled their travel expenses by that amount may be about to be held to account. Last June independent investigators known as the Scorpions arrested several travel agents for falsifying official travel vouchers for the private benefit of certain MPs. This week, according to reports, some 40 current and former lawmakers—the equivalent of one in ten of all MPs—were due to be arrested and charged with fraud.

The MPs apparently stayed at luxury hotels, dined at fancy restaurants and treated friends and relatives to flights, while chalking it up as official business. Most political parties are implicated, and the scandal could grow larger.

An opposition leader, Douglas Gibson, told a local paper that as many as 100 MPs had a “serious involvement” in the scam. One of his colleagues, Craig Morkel, is the first casualty: he says he will give up politics while he fights the charges against him. Any MP convicted of a serious crime (with a jail sentence longer than one year) will be obliged, under the constitution, to resign.

A poll published this week found that three-quarters of South Africans think that corruption is getting worse. In fact, South Africa is far less grubby than some of its neighbours, but it is a constant battle to keep it that way. The Scorpions are in the vanguard. For example, thanks to their efforts, Schabir Shaik, a financial adviser to the deputy president, Jacob Zuma, is on trial in Durban for alleged fraud.

Fighting high-profile cases matters. If junior officials or policemen see big-time crooks caught and punished, they may decide that stealing public money or harassing motorists for bribes is not worth the risk. For different reasons, corrupt and honest South Africans alike will be watching with interest to see if any MPs are jailed over the travel scam.

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Europe, America and Iran

Jaw-jaw, for now

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From The Economist print edition

But is diplomacy doomed?

Get article background

IF THE time for diplomacy is now, as Condoleezza Rice, George Bush's new secretary of state, famously puts it, those hoping to block Iran's nuclear ambitions have a funny way of showing it. Mr Bush says he supports the diplomatic efforts of Britain, France and Germany to talk Iran out of its technology to produce uranium and plutonium (both possible bomb ingredients), though he refuses to rule out other options, including military ones. And he has let his vice-president, Dick Cheney, muse aloud that no matter how patient America remains with Iran, a twitchy Israel might be less so.

Iran's defence minister, responding to a report in the *New Yorker* that American forces were already on Iranian soil scouting out likely nuclear, chemical and biological targets, hinted that his country already has the bomb. At least, it is hard to imagine what else he could have meant by "the greatest deterrent force".

Does diplomacy stand a chance? The first deadline for the Europeans and the Iranians to come up with the bones of a tension-defusing deal, following the "temporary" suspension of Iran's enrichment efforts in November, is March, but the going is tough. The Europeans want to make the suspension permanent. Iran says no. Britain's foreign secretary, in Washington this week to confer with Ms Rice, had previously described the use of force against Iran as "inconceivable". Mr Cheney may have been attempting to strengthen the Europeans' negotiating hand—and stiffen spines—by suggesting that, if diplomacy fails, others could conceivably react more forcefully.

At the heart of the wrangle are "objective guarantees" about Iran's nuclear intentions. It says it wants to produce uranium only as fuel for nuclear power. But the Europeans point out that once it has mastered making low-enriched uranium needed for power reactors, it would also be able to make the highly-enriched sort needed for bombs. Given its proven record of nuclear cheating, they want Iran out of the nuclear-fuel business entirely. In return they are offering better trade and political relations, and help with other nuclear technologies.

Possibly no inducements would work. But to offer big enough carrots to test that proposition, the Europeans will eventually need America's help. So far, the Bush administration has balked: it does not want to reward a country that breaks its nuclear promises, supports terrorist groups and denies Israel's right to exist. Only the prospect of real guarantees against future nuclear misconduct might tempt America to join the diplomacy.

Iran offers only "assurances". What might these be? Offering to allow international supervision of any further fuel-enriching, perhaps. Possibly keeping only its small pilot enrichment plant going, while mothballing the larger one it has been building. But leaving any enrichment equipment in

Iran would also leave it with the option of making a bomb.

Some combination of offers and threats may yet deflect Iran from further enrichment work. That would take concerted pressure from Europe, America and others, including Russia and China. If the Europeans get nowhere, Iran's nuclear transgressions could be reported to the UN Security Council. But would it then impose sanctions that would give Iran pause?

Iran is dangling oil and gas contracts before China, Russia and others to persuade them to break ranks. It is also playing for time. It has already presented the Europeans with a long and impossible list of security demands. Another tactic might be to agree to extend the enrichment suspension, but only in return for concessions that loosen the constraints it imposes—rather as North Korea did in its now-abandoned 1994 nuclear deal with America.

As the diplomatic going gets stickier, expect more of the blame game. Just as America attempted to use Israel's concerns to raise the stakes (provoking the retort from Israel's vice-premier that Iran's nuclear sins should be everybody's business), so the Iranians call America “crazy” for supposedly obstructing diplomacy.

Some Europeans sing a similar tune. But for them this is a dangerous game. If Iran succeeds in blocking agreement on sanctions at the Security Council, it might calculate it was home free. Then some of those military options being talked about, however imperfect, may yet be tried.

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Anti-Semitism in Europe

Always with us?

Jan 27th 2005 | BERLIN, BRUSSELS, PARIS AND RIGA
From The Economist print edition

Getty Images

Worries about anti-Semitism in Europe clouded this week's commemoration of the liberation of Auschwitz

“NEVER again.” That was the message of political leaders gathering this week in Auschwitz to mark the 60th anniversary of its liberation, including heads of state from France, Germany, Russia, Poland and Israel. And it was the message many sent in their own countries. “Remember”, said President Jacques Chirac, as he unveiled a Shoah Memorial in Paris that features a wall engraved with 76,000 names of those sent to their deaths from France. “Do not forget.”

Yet the ceremonies come at an awkward time. A report released this week by Natan Sharansky, an Israeli government minister, concluded that “anti-Semitic expression has grown over recent years” and that “the greatest number of events and the most severe attacks occur in Europe.” Another report, from America's State Department, speaks of “the increasing frequency and severity of anti-Semitic incidents...particularly in Europe.”

Linking the Holocaust to today's anti-Semitic attacks may seem far-fetched. But some have raised the spectre of a new persecution of European Jewry. One Auschwitz survivor, Elie Wiesel, told a conference in Brussels last year that European Jews were living in fear. “Don't say they are paranoid, they are not. They are simply realistic,” he said. Charles Krauthammer, a columnist, wrote in the *Washington Post* in 2002 that “in Europe, it is not very safe to be a Jew”, adding that “what is odd is not the anti-Semitism of today but its relative absence during the past half-century. *That* was the historical anomaly.”

How bad is anti-Semitism in Europe today? The number of incidents recorded in the Israeli report

jumped by 20% in 2004. France, home to Europe's biggest Jewish and Muslim populations, is often thought of as the worst offender, and the report duly puts it at the top of the list in 2004. Yet it also says that “anti-Semitic expressions have somewhat declined” in France since mid-2004. And it points to a steep rise in Britain as “alarming”, and to a “disturbing” trend in Russia and Ukraine.

Who are the perpetrators? In western Europe, the State Department identifies “disadvantaged and disaffected Muslim youths” as increasingly responsible, alongside traditional far-right groups. In central and eastern Europe and Russia, skinheads, ultra-nationalists and other far-right elements are more often to blame.

The causes seem to fall into two broad categories. The first is the import into Europe, often via television images, of the Arab-Israeli conflict. In France, for example, anti-Semitic attacks, often perpetrated by Muslims, rose steeply after the second *intifada* began in 2000. The second is a confused mix of anti-Americanism and a belief that, as the State Department puts it, “the Jewish community controls governments, the media, international business, and the financial world.” This fits the prejudices of both the far right and radical Islam. Anti-Semitism is not necessarily coherent or even organised. A recent study commissioned by the French government found that, of 166 violent attacks, 11 were motivated by neo-Nazism; about 50 by the Arab-Israeli conflict; the rest were attributed to general “disaffection”.

Yet Marc Knobel, of the Representative Council of French Jewish Institutions, says “the image of France as an anti-Semitic country is nonsense.” Most French Jews are well-integrated. There were still 194 violent anti-Semitic acts in 2004, by the government's definition, up from 112 in 2003. What has changed, say Jewish groups, is that the French government is now taking the matter seriously. Even the Israeli government recognises France's effort in fighting against anti-Semitism.

Certainly Mr Chirac now reacts strongly. “Anti-Semitism has no place in France”, he said this week, adding that it was not an opinion but a perversion. His strong words were echoed in Germany by Chancellor Gerhard Schröder, who said that anti-Semites should never again “be allowed to bring disgrace on our nation.” Mr Schröder was speaking a few days after deputies of the far right National Democratic Party (NPD) in Saxony caused a scandal by refusing to join in a minute's silence for victims of the Holocaust, and by insisting that the bombing of German cities, particularly Dresden, was “cold-blooded, premeditated, industrial mass-murder.”

There are signs that the post-war taboo against speaking ill of Israel, or of Jews in general, is eroding

Yet on the whole Jews in Germany see little cause for alarm. “There is anti-Semitism,” acknowledged Julius Schoeps, a prominent German Jewish historian, last year. “But no more nor less than in previous years.” To be sure, anti-Semitic crimes by right-wing extremists happen in Germany, as elsewhere, and militant Islamic vitriol against Jews is watched with growing concern. The percentage of Germans admitting to negative views of Jews also rose between 1998 and 2003, but only from 20% to 23%. And the Jewish community in Germany is now the world's fastest-growing. Each year for the past decade, some 15,000-20,000 Jews have arrived from the former Soviet Union.

There are, however, signs that the post-war taboo against speaking ill of Israel, or of Jews in general, is eroding, in Germany and in other countries. Some observers fear that social acceptance of anti-Jewish speech is rising. Across Europe, anti-Israel (or, more specifically, anti-Ariel Sharon) feeling is strong: it is often hard to separate this from anti-Semitism, and the first can be used as an excuse for the second. In Germany, at least, racist outbursts by politicians are still swiftly condemned: the incident in Saxony's parliament prompted new calls to ban the NPD.

Anti-Semitism crops up in some unexpected places around Europe. In the Netherlands last October, a referee called off a football match because he was receiving so much anti-Semitic abuse. This week the Muslim Council of Britain refused to take part in Holocaust Memorial Day because the organisers would not link it to a condemnation of “genocide” in Palestine.

The story is different in central and eastern Europe, partly because relatively few Jews (or Muslims) now live there. Before 1939, when Poland had the largest Jewish community in Europe, it was also known for its tradition of anti-Semitism. After the war, the communist regimes that took over in central Europe were slow to publicise or even to acknowledge the Holocaust. They were certainly reluctant to accept the part played by their own people: witness the huge controversy over the 1941 Jedwabne massacre, thought to have been perpetrated by Poles, not Germans.

Now these countries have thrown off the Soviet yoke, anti-Semitism seems in general to be diminishing. It is mainly a preserve of far-right groups in countries such as the Czech Republic and Slovakia. If anything, it is worse in the Balkans than in central Europe or the Baltics. But the most worrying strain of anti-Semitism is not in European Union members, whether old or new, at all. It is farther east, in Russia (see article). That is where reminders of the attitudes that culminated most hideously in Auschwitz may be needed most.

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Russian anti-Semitism

An ugly head rears

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More worrying than in the rest of Europe

EVEN under Leonid Brezhnev, when would-be émigrés were persecuted and Jews had trouble entering some universities and professions, Communist propaganda had its limits: it was careful not to criticise Jews in general or denigrate Judaism as a faith. No such shyness held back the editors, politicians and other Russian nationalists who, in an open letter published this week, suggested a novel response to anti-Semitism: banning all Jewish organisations. With an atavistic crudity that sent shivers down liberal Muscovite spines, the signatories said that recent signs of anti-Semitism were either a fair response to the "typical Jewish characteristics" which every good patriot deplored; or they were provocations, committed by Jews themselves.

While Stalin's propagandists alluded to Jews with code-words such as "cosmopolitan", the new letter was blunter. Parts of it read like an extract from the "Protocols of the Elders of Zion", a work of anti-Semitic propaganda used by the tsarist police and later by the Nazis. In the classic tones of conspiracy, the letter declared that "the entire democratic world is under the monetary and political control of international Judaism, which high-profile bankers are openly proud of." If the intention was to shock, and to test the reactions of President Vladimir Putin as he prepared to go to Auschwitz, the response was quick. The Foreign Ministry said the letter had "nothing in common with the official position of Russia's leadership" and called its timing "especially regrettable".

Both the letter and the response to it confirm what many Russia-watchers already felt. On the one hand, anti-Semitism (which has deep roots in Russia) still seethes, a few millimetres below the surface of Russian life—though these days it co-exists with even more widespread kinds of prejudice, such as hatred of Chechens and Caucasians. On the other hand, Mr Putin, mindful of Russia's image and of his good personal relations with senior Israelis and Jews, is anxious to stop anti-Semitism bursting out into the open.

"In private conversation, senior Russian officials often make anti-Jewish remarks, but they take care not to repeat them in public," says Dimitri Simes of the Nixon Centre, an American think-tank. In their campaign against Russia's oligarchs, several of whom are Jewish, Mr Putin and his team have avoided mentioning the tycoons' origins. But might that change? Could a future Russian government decide to play the anti-Semitic card, knowing that it can draw on widespread xenophobia?

That risk may become acute if there is a broader political crisis—as could happen if the coalition of bureaucrats, nationalists and security chiefs that now controls the Kremlin breaks apart. That seems unlikely in the very near future, though Mr Putin's grip seems at least fractionally weaker than it did only a few months ago. But whatever the future holds, says Masha Lipman of the Carnegie Centre in Moscow, "a political change, brought about by a crisis, is certainly not going to bring more tolerant, liberal people to power."

What this week's spat over anti-Semitism has highlighted is disturbing, even so. If illiberals (ie, characters even less liberal than today's incumbents) were to take control, the demons of prejudice are ready for them to conjure up. Indeed, some are at work already: on January 14th, two rabbis were assaulted on a Moscow street.

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Spain

Attacked from the right

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Protesters rough up Spain's macho defence minister

SPAIN'S defence minister, José Bono, likes to wrap himself in the national flag. He is less used to being struck by one, as he was at a protest last weekend staged by the Association of Victims of Terrorism in Madrid. The 35,000-strong rally was called to commemorate all victims of terrorism, including those killed in the March 11th Madrid train bombings. But the protesters' bigger target was the Basque terrorist group, ETA. And the attack on Mr Bono was the work of right-wing thugs.

What Mr Bono, a devout Catholic and patriot who prides himself on being a *macho ibérico*, received seems to have been a "gay-bashing", provoked by the government's promotion of gay rights. "Hate-filled women" in fur coats punched him; others called him an "assassin" and a "defender of poofters". He and another Socialist politician fled, after a man wielding an iron bar joined the attack. The police questioned two members of an opposition People's Party (PP) committee, one of whom was photographed clasping a broken flagpole.

That the macho Mr Bono, of all Socialists, should be attacked shows both how few brains the mob had and how edgy some on the right now are. As a spokeswoman for the March 11th Victims Association, Pilar Manjón, who did not attend the rally, said, "it seemed like those people were the same ones who told me that they would 'stick my dead up my arse'." Another target of verbal abuse was Gregorio Peces-Barba, a Socialist recently appointed as ombudsman of all victims' groups. He called on both main parties to stop making political capital out of victims.

Neo-fascist skinheads were notably absent from the rally. A PP spokesman roundly condemned the attacks, which were started by middle-aged right-wingers. The old nationalist chant, "United, Spain will not be defeated", was directed at the Socialist government, whose opposition to the Basques' plan for a referendum on becoming a free state is deemed too soft. Fears are also stirring on the right since the government said it might talk to ETA if it laid down its weapons for good.

Above all, the attacks point up how angry right-wingers are over the government's raft of social reforms. They also testify to a refusal to come to terms with the PP's defeat last March. Many believe the election was stolen only by the aftermath of the March 11th bombings.

Yet most Spaniards still back the Socialists. The latest polls put the government of José Luis Rodríguez Zapatero eight points ahead of the PP. And one poll shows a seven-point rise in the popularity of the PP leader, Mariano Rajoy, after he resisted a more antagonistic path and made a pact with Mr Zapatero to present a joint response to the Basques. Less rabble-rousing and more deliberation are surely the best route for the PP to take.

Ukraine's new president

After the party

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AP

Victor Yushchenko takes office—and chooses a controversial prime minister

HE HAD done it before, but this time it was for real. In November, after the presidential election was stolen by his opponent, Victor Yanukovich, in a rigged vote, Victor Yushchenko took a symbolic presidential oath in the Rada, Ukraine's parliament, while protesters chanted his name outside. The scene inside the Rada was only slightly more orderly on January 23rd, when he was officially sworn in. After a brief speech in parliament, the new president fittingly made another on Kiev's Independence Square, the heart of the insurrection that propelled him to victory.

Mr Yushchenko declared that Ukraine's future lay in a united Europe. Javier Solana, the European Union's foreign-policy honcho, had already dropped by (Colin Powell, America's outgoing secretary of state, was also in attendance). The new president then spent most of his first week in office travelling. In Strasbourg he bumped into Mikhail Saakashvili, who became president of Georgia after its “rose revolution” in 2003. Heady talk of an early application for EU membership has given way to more pedestrian offers of improved trade and visa rules. But before going west, Mr Yushchenko paid a quick call on the Kremlin—even though Vladimir Putin, Russia's president, had sent an insultingly low-level delegation to Kiev, and was far slower to congratulate Mr Yushchenko on his relatively clean win than he was to congratulate Mr Yanukovich in November.

The two presidents have much to discuss, including Ukraine's participation in a Russian-led single economic space and its aspirations to join NATO. This time, despite the Kremlin's brazen interference on Mr Yanukovich's behalf, Mr Yushchenko diplomatically extolled Russia as a “strategic partner”. This wary warmth was partly designed for internal consumption, in the Russian-speaking southern and eastern regions of Ukraine that had voted overwhelmingly for his opponent.

But other political imperatives lay behind Mr Yushchenko's choice of prime minister. Jockeying among candidates had been intense, but Yulia Timoshenko—as reviled by some of Mr Yanukovich's supporters as she is adored by some of Mr Yushchenko's—insisted she would get the nod. She proved right. As chameleonic as she is glamorous, Mrs Timoshenko prospered as an energy-trading oligarch; was a deputy to Mr Yushchenko when he was prime minister; stands accused of fraud in Ukraine and of corruption by Russian prosecutors; and has reinvented herself as a revolutionary demagogue.

Mrs Timoshenko's appointment must be ratified by the Rada in early February. Though a heroine to the inhabitants of the tented city that sprang up in central Kiev after November's rigged poll, she has irked other elements within Mr Yushchenko's orange coalition. But a little mollification on her part, plus judicious distribution of remaining ministerial jobs, should see her though the vote and into power.

What would that mean for government policy? Mrs Timoshenko has been the most relentless critic of Leonid Kuchma, the outgoing president, and his cronies. Mr Yushchenko has pledged to re-examine the old regime's most egregious abuses, not least its alleged role in his own poisoning, and its dodgiest privatisations; a Kiev court is hearing a challenge to one of the most scandalous. But here, too, a moderate beginning would be sensible.

Mrs Timoshenko was also against the constitutional reforms agreed with Mr Kuchma during the election crisis, under which many functions hitherto performed by the president are to be transferred to parliament (and thus to a future prime minister). There is now talk of revisiting that deal, too. But even though Mr Kuchma drove through the reform, it would be good for Ukraine. Having come to office as legitimately as, in the circumstances, he could, it would be a shame if Mr Yushchenko were now to cling on to powers that he had earlier agreed to relinquish.

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Troubled Moldova

Tilting westward

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Yet another ex-Soviet republic looking to the European Union

WHEN Victor Yushchenko won the Ukrainian presidency, many Russians declared that Russia had "lost" Ukraine thanks to western meddling. Yet in Moldova, Russia is proving quite capable of losing an ally without western help. Four years ago, Moldova's Communist Party won election by promising pro-Russian policies, including eventual union with Russia and Belarus. Now they are chasing re-election in March by promising pro-western policies, including integration with the European Union. They changed course because even they could not stomach Russia's strategy of keeping Moldova divided and weak.

The Communists now want Russia to pull its troops out of Transdniestria, which is controlled by a sinister regime under a Russian-born "president", Igor Smirnov. Russia helped Transdniestria to win a bloody war of secession after the Soviet collapse of 1991, amid spurious claims that Moldova might be swallowed by Romania. When the Communists won power in 2001 they hoped Russia would support reunification, with modest guarantees of Transdniestria's autonomy. Instead, Russia pushed for a treaty giving Transdniestria near-independence within a federal state, enough seats in parliament to block constitutional change—and the long-term presence of Russian troops.

Moldova's Communist president, Vladimir Voronin, came within a day of signing this treaty in late 2003, but backed off after western warnings. The U-turn to Europe followed. But will the new course bring Moldova any closer to building a normal economy and government? This post-Soviet wreck is the poorest country in Europe, heavily reliant on farming and foreign remittances. Yet voters may take a step in the right direction by weakening the Communist Party in the elections. Despite its new pro-western orientation, the party remains a secretive bureaucracy with dubious democratic credentials and a chokehold on the broadcast media. After opposition victories in Ukraine and Romania, Moldova is a “red stain in an orange sea”, says one local politician.

The polls suggest that the Communists may not gain a majority in the 101-seat parliament, let alone the 71 seats they won last time (enough to change the constitution). Three other groups will probably share the chamber: the pro-western Christian Democrats; the Social Democrats, backed by business interests; and Democratic Moldova, a fractious coalition within which Moscow has been fishing for allies. Two openly pro-Russian parties may not win any seats. But the crucial point is that constitutional change will be far harder in a divided parliament.

A better and more open government in Moldova will deserve a lot more international help, starting with the neighbours. Romania is already offering diplomatic support (see article). Ukraine could offer vital practical help. Transdniestria's smugglers and arms salesmen—the backbone of the economy, along with a big Ukrainian-owned steelworks—trade through Ukraine, especially via Odessa. The Ukrainian government could cripple Transdniestria by policing the common border tightly. But that would upset Ukrainians.

If Moldova is to achieve deep and irreversible change, however, the EU must offer it a clear path towards eventual membership. It has done this for the Balkan countries, which are no more European and no less troubled than Moldova. Its reluctance to talk of membership for Ukraine looks short-sighted: when Ukraine joins the queue, geography will dictate giving a place to Moldova too. The sooner the process is started, the less the danger of either country wobbling off-course.

This assumes that the Transdniestrian problem will, in effect, solve itself, as the future benefits of EU integration outweigh those of separatism. But Russia will be a big obstacle. At worst, it might even step up its military presence in Transdniestria, to make a second Kaliningrad: a Russian fortress in south-east Europe. The best counter-strategy would be to confront the Russians openly over what they are protecting in Transdniestria: a big, ugly smuggling racket, with a piece of land attached. Even Russia may not want to spend too much political capital in such a cause.

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Romania

Black Sea captain

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A promising start to a presidency

TRAIAN BASESCU pitched into Romania's presidential election only two months before polling day, when Theodor Stolojan, the centre-right opposition candidate, dropped out. His victory on December 12th over Adrian Nastase, the outgoing socialist prime minister, owed as much to personality as to policies. Voters wanted a change, they blamed the socialists for Romania's corruption, and they saw the plain-spoken Mr Basescu, a former sea captain and mayor of Bucharest, as a rare honest man.

Mr Basescu must now decide on his priorities. Top of the list is the fight against corruption, a gargantuan task but one that he and his supporters care about most. Closely linked is the goal of getting ready for European Union membership in 2007 or 2008 (the EU has the option of delaying by a year). The main non-EU foreign priority is closer ties with America, mainly through NATO, which Romania joined last year.

Britain, a strong supporter of NATO and EU enlargement and America's closest ally in Europe, does well from this mix. Mr Basescu, who visits London next week, has called for a “Washington-London-Bucharest axis”. France, historically a close friend of Romania, does less well. Mr Basescu attacked the government for giving a road contract to a French firm without an open tender, and wants it reviewed. Contracts with German and American firms are also at risk, but the French one is most vulnerable.

Mr Basescu wants Romania to play a bigger role around the Black Sea. He starts with Moldova, most of which was Romanian before the second world war. Last week, he chose Moldova for his first foreign trip. He told Moldovans that they should call Bucharest when they had problems, and promised to act as “advocate” for their integration with the EU. Many Moldovans fear that Romania still has designs on their country. Mr Basescu's comments should reassure them—rather more than did his call, just after his election, to “treat the Moldovans like good Romanians”.

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Charlemagne

Low-cost founding fathers

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How cheap air flights are bringing Europeans together

Get article background

BRUSSELS is full of monuments to the “builders of Europe”. There is the Schuman district, the Monnet circle, the Spinelli building. It may now be time for a Stelios Square or a Boulevard O'Leary. For in recent years, Stelios Haji-Ioannou and Michael O'Leary, the two pioneers of Europe's low-cost airlines, have done more to integrate Europe than any numbers of diplomats and ministers. They have helped to create a new generation for whom travelling to another European country is no longer exotic or expensive, but utterly commonplace.

On a recent Friday night at Stansted airport, near London, it was easy to see how people's lives have changed. There was Ettore Thermes, an Italian financier, who commutes every week between his home in Rome and his office in London and says “I use the plane like a bus.” Or Suzy Romer, a Scottish student visiting her boyfriend in Bilbao, who noted that “what these airlines do is let you live in two countries at once.” Then there was a group of middle-aged men and women, who schedule weekends away in Europe around the fixtures of Leicester rugby club: that particular weekend they were heading for Bergamo in northern Italy. And there were American backpackers marvelling at the fact that their flights to Barcelona had cost the same as their train tickets from London to Stansted.

None of these people had paid more than £50 ($95) for their flights. All agreed that they were taking journeys, and indeed making choices about their lives, that would have been quite impossible before the low-cost revolution. Indeed Europeans are now so blasé about hopping on a plane that confusion can easily result. Last summer your correspondent got chatting to a British traveller still hanging around the airport in Rodez, in France's Massif Central, more than an hour after the arrival of her Ryanair flight. “My friends will be arriving by boat soon,” she asserted confidently. On further questioning, it emerged that she thought she was on the Greek island of Rhodes.

Confusion, if not perhaps on this scale, is understandable. The network of low-cost routes around Europe is huge. From Stansted that Friday, Ryanair alone was flying to some 70 different destinations, as far apart as Aarhus in Denmark and Zaragoza in Spain. EasyJet was flying to 25 cities, with a further 25 served from Luton. And although the low-cost revolution began in Britain and Ireland, and is still best-established in these two countries, it has now spread right across the continent.

The new EU members in Central Europe are the latest to catch the bug: they have a favourable combination of low labour costs, interesting new destinations and populations eager to taste the new freedom of travelling west without a visa. Wizz is based in Hungary and Poland; SkyEurope flies from Slovakia and Poland. In Germany Lufthansa now has 12 low-cost competitors on domestic routes. Some newcomers such as Air Polonia and Italy's Volare have gone bust, but

other new carriers seem to pop up almost every week. The industry is still expanding rapidly. Low-cost airlines carried 80m passengers in Europe in 2004, up from 47m in 2003. They have over 20% of the European market today and may reach 40% by 2010.

The inspiration for the low-cost revolution came from America, and particularly from the success of Southwest Airlines. The British and Irish were the first to pick up on the trend, in the early 1990s. As Anglophone countries, they are often quicker to copy ideas from the United States; and their relatively flexible labour markets, affluent consumers and island geographies also encouraged low-cost carriers. The surge in British holidaymakers buying houses in France is closely linked to the rise of low-cost airlines. And it is not just travellers who feel the benefits. Entire regional economies have felt the impact. The city of Carcassonne in south-west France reckons that the 235,000 passengers who arrive every year on low-cost airlines have created over €270m ($360m) of extra economic activity.

On the downside

Inevitably, there are grumblers. Many believe that rising oil prices and increasing competition must lead to a big shake-out in the industry. Even Mr O'Leary has warned of an impending "bloodbath". Some of the prices on offer are so low that one wonders wickedly whether some of the airlines might not have a more profitable sideline: smuggling? piracy? But even if a bloodbath did take place, it seems safe to say that the low-cost habit is now so firmly established in Europe that the days of rip-off airfares will never return.

So much the worse, groan environmentalists, who complain that the spread of low-cost airlines is hugely polluting and a prime contributor to global warming. The European Commission in Brussels is looking into raising "aircraft emissions charges" to take account of their environmental costs. The commission is already unpopular with Mr O'Leary for ruling that Ryanair received illegal state-aid from the local government in Charleroi, its Belgian base. The low-cost airlines are also angry about new EU regulations passed last year that could increase compensation for passengers whose flights are cancelled.

Yet nobody should lose sight of the fact that the Eurocrats and the low-cost carriers are natural allies. The conditions for Europe's airline upheaval were created by EU legislation. Through a succession of liberalisation packages, the commission broke the power of national flag-carriers to monopolise routes between and within European countries. It is EU law that allows a low-cost British upstart such as easyJet to compete with Air France on such lucrative domestic routes as Paris-Toulouse. By allowing newcomers to enter the market, Brussels has achieved that rare thing: an unambiguous triumph both for European consumers and for the ideal of "ever closer union" in Europe. When they have stopped arguing with Mr O'Leary, the Eurocrats might consider putting up a statue to him.

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Immigration policy

Howard's way

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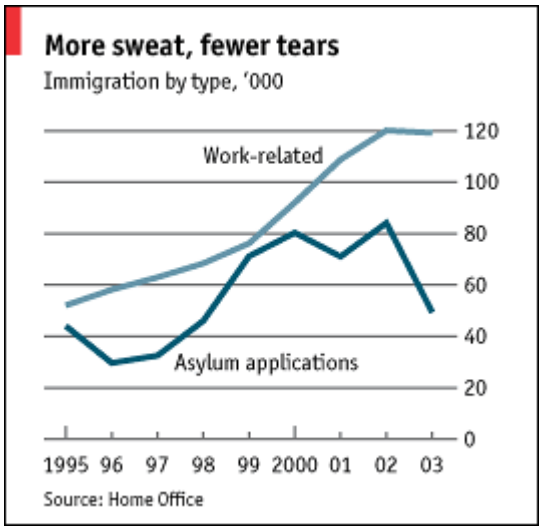
The Conservatives propose a radical overhaul of the immigration system

Get article background



JOHN HOWARD, the Australian prime minister, was heading for electoral defeat in 2001 when a boat full of Afghans appeared on the horizon. It was just the thing to revive his campaign. Loudly proclaiming that the nation's borders must be protected, Mr Howard saw off the refugees and the opposition Labor Party. This week, another Howard—Michael, in other words the one who runs Britain's Conservative Party—announced that "immigration must be brought under control". The suggestion that he is trying to copy his Antipodean counterpart might seem unfair, except for the fact that the Conservatives plan to import much of the Australian immigration system, too.

Immigration into Britain is both unpopular and historically high, although not, these days, because of Afghan refugees. Between 2002 and 2003, the number of people seeking asylum in Britain fell from 84,130 to 49,405; last year's tally is likely to be lower than that of 1995, when Mr Howard was home secretary. The real flood of immigrants is comprised of workers and people entering as spouses or relatives of Britons. In 1999, there were almost as many asylum-seekers as economic migrants. In 2003, asylum-seekers were outnumbered more than two to one. And that is without counting workers from the EU.

Believing that overall numbers matter most, the Tories plan to follow Australia's and Canada's lead by setting annual immigration limits. The huddled masses would be divided into "streams" of economic migrants, family members and refugees, with the hint that numbers in all three categories will be cut from present levels. Those who wish to work will be assessed by a points system designed to cherry-pick the sort of labourers Britain needs.

Most radically, the Conservatives propose to stop hearing refugee claims in Britain. Anybody who somehow finds their way past toughened border controls will be packed off to a foreign detention camp while their case is heard. That is expected to reduce the numbers arriving in Britain. A Conservative government "may", as a result, be able to take more deserving cases from the United Nations (as Australia currently does), again within the limits imposed by a quota. As David Davis, the Conservative home affairs spokesman, admits, this scheme means ditching the 1951 Geneva Convention on refugees. It may also fall foul of an EU agreement on asylum that was agreed last year, as well as the European Convention on Human Rights.

Not all of the Conservatives' ideas are novel, even in Britain. Quotas are, for example, already

applied to agricultural workers. If you are an animal gut remover aged 18 to 30, the nation's doors are open. Skilled would-be migrants are currently evaluated according to a points system. The government has made life much more difficult for asylum-seekers and is trying to improve the tracking of immigrants.

The difference between Labour and Tory policies, says Des Browne, the immigration minister, is that the government is “not proposing to recreate, in the northern hemisphere, the isolation that is imposed on Australia by virtue of its geography.” That means no cap on the numbers of refugees or immigrant workers.

For all their bluster about flaws in the present regime, the Conservatives cannot reduce immigration other than by accepting fewer overseas workers. This is easily done: simply reduce the total number of work permits. But how to decide who gets them? The much-admired Australian system has a skills list: chiropractors earn a 60-point bonus, while massage therapists get only 40. Go to a small town and you will earn more points.

That system could be imported, but as John Philpott, of the Chartered Institute of Personnel and Development, points out, it would look remarkably like 1970s-style manpower planning. And, after all, the Conservatives are supposed to believe that governments should avoid meddling with the labour supply.

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Universities

Repointing the spires

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Oxford wants to be more like Harvard. That will annoy a lot of people

Get article background

A SMALLER slice of a smaller cake. That is the unappetising prospect that Oxford is presenting to the worried, ambitious parents of the middle class. It is they that benefit most from the status quo: their children get an undergraduate education which costs £18,600 a year to provide according to Oxford's inflated estimate, or more realistically, £10,000 ($18,700). At any rate, with fees at only £1,150, and the taxpayer providing another £5,000-odd, the burden on the university leaves it broke. Buildings are shabby, dons underpaid. If Oxford is going to compete with places like Harvard, that can't continue.

So the new vice-chancellor, John Hood, is proposing to shift focus, cut costs and raise revenues. There will be less emphasis on undergraduate teaching—something that most top universities regard as a chore better left to lesser outfits. The overall number of undergraduates will fall by a tenth. They will receive less teaching, and less of it in the tiny tutorial groups that are the university's hallmark. More of the remaining teaching will be done, Harvard-style, by graduate students. And the shrunken undergraduate business will be run more profitably: those admitted at full-cost fees, from countries outside the European Union (EU), will rise from 8% to 15% over the next ten years.

Others with similar ambitions are likely to follow suit. Britain's top universities already look longingly at the London School of Economics, which recruits half its undergraduates at full fees, and thus enjoys enviable independence from government. Few have recruited as aggressively overseas so far, but Oxford's example raises the pressure to do likewise. Cambridge, whose financial plight is worse than Oxford's, said it would not cut overall undergraduate numbers, but left open the option of taking more full-fee students.

The plan could well help Oxford's finances. But it would mean cutting subsidised places for undergraduates from Britain and the EU from some 10,400 now to just 8,500 by 2015. That shift will annoy vocal middle-class parents who feel that as taxpayers they have put a lot of money into Oxford and other top universities, and would therefore like their children educated there, cheaply and in as large numbers as possible.

It will also hurt the government's plans for getting more pupils from mainstream state schools into the top universities. If numbers fall and admission standards therefore rise, the best applicants, who tend to come from fee-paying private schools and selective state ones, will do even better than they do now.

The political risk is heightened by Oxford's lack of allies. Whereas places like Harvard are almost universally admired in the American education world, Britain's top universities are oddly

unpopular. A chunk of the education establishment believes Oxford-type education is elitist, or at least costly and overrated. “They claim to spend three to four times what we get to educate one undergraduate. How come others can do it for so much less?” asks Mike Driscoll, vice-chancellor of Middlesex University.

The latest plan is best seen as an opening move in a long tussle with the government. The big prize would be realistic fees, instead of the increase to a mere £3,000 in 2006 that the government has granted. Some dons would like a still tougher stance, backed by the threat of going private: the state teaching subsidy, after all, is only a tenth of Oxford's £1.1 billion budget. But for now, at least, Mr Hood is trying to stay in the state system, rather than risk life outside it.

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London's Assyrians

Babylon or bust

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From The Economist print edition

Lessons in lobbying from a small but ancient émigré group

GEORGE CAREY, former Archbishop of Canterbury, has had a busy week. Before flying off to Davos to network with business leaders, he launched a campaign called “Save the Assyrians” in a Westminster committee room. The aim of the campaign is to put pressure on the British government to make sure that Iraq's Assyrians are protected when the country's new constitution is drawn up. Mr Carey's intervention will undoubtedly help their cause. But the Assyrians already have two advantages over other lobbyists. First, they have a record of service in Britain's armed forces. Second, as oppressed representatives of the oldest Christian church, who still conduct services in Aramaic (the language spoken by Jesus), they have unrivalled romantic appeal.

Assyrians in Britain have, until now, chiefly been noted for their ability to understand Mel Gibson's film “The Passion of the Christ” without the help of subtitles. They have also shown their prowess as football referees in the Middlesex amateur league, according to Stephen Pound, MP for the leafy Ealing district of west London where most of Britain's 8,000-strong diaspora live. Some came in the 1940s and 1950s, and they were then joined by a second wave after the Iran/Iraq war in the 1980s.

While this group is small by international standards—Brazil is home to about 80,000 and there are 20,000 in the Netherlands—many either fought, or have family members who fought, alongside the British in the second world war (the Assyrian Levies even had their own parachute squadron). Andy Darmoo, who runs a lighting business when he is not campaigning for Assyrian rights, says that most of the people who pass through the Assyrian centre in London have some relationship with the armed forces. His father, for example, spent 31 years in the Royal Air Force.

“The British have to help us, because we served with them,” says the Rev Stephen Yalda Turkhan, priest at the Assyrian Church of the East. Mr Darmoo says this must be done delicately, though. Assyrian Christians have already been targeted by insurgents in Iraq: two churches were blown up in December. Any sign of favouritism from the co-religionist occupying powers could backfire. “We do not try to make trouble for any people, for any neighbours,” says Mr Yalda Turkhan.

Old alliances aside, there are other reasons why the Brits ought to intervene on behalf of the Assyrians. After all, they have them to thank for perhaps the most beautiful objects in the British Museum, the 2,600-year-old bas-reliefs of lion hunts from King Ashurbanipal's palace. The Assyrians reckon the rent on them is now due.

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European constitution campaigns

Yes or nein?

Jan 27th 2005
From The Economist print edition

The unequal fight between supporters and opponents of the constitution

Get article background

ONE question, published this week, will keep the prime minister awake at night once the tiresome business of the general election is over: “Should the United Kingdom approve the treaty establishing a constitution for the European Union?” Mr Blair will not have to face the answer until 2006. But if the voters say “no”, as opinion polls currently suggest they will, it could cost him his job. Worse, one senior civil servant reckons a “no” vote would bring on “the worst foreign policy crisis for Britain since Suez”.

Given this, the apparent slothfulness of the “yes” campaign is odd. The government has hired a PR firm to spread awareness of the joys of EU membership. In the country with the most Eurosceptic press on the continent, this will be tough; and its budget is a miserly £40,000 ($75,000).

The rest of the “yes” campaign is short of money, too. Britain in Europe (BIE), the main campaign group, had an income of just £650,000 last year. Its staff has shrunk from 35 to only 16. After months of anonymous leadership, it has appointed Anthony Nelson to sell the constitution to the public. But Mr Nelson, a former Conservative MP who joined the Labour Party in 2001, is hardly a household name. Most high-profile Tory Europhiles are either sulking, after what they saw as Mr Blair's spineless acceptance of an unnecessary referendum; or staying quiet, so as to avoid embarrassing their increasingly Europhobic party in the run-up to an election.

A bigger problem for the “yes” campaign than either penury or lack of clout, though, comes from the collapse of enthusiasm among British businesses. When BIE was launched (to campaign for the adoption of the euro) it had intellectual and financial support from large multinational firms based in Britain. Now, Euro-gloom among businessmen even extends to the single market, supposedly the EU's proudest achievement. Back in 1998, 75% of British businessmen agreed that EU membership had benefited British business. But a recent survey of 451 senior executives conducted by Accenture, a consultancy, for the Royal Institute of International Affairs, found that only 32% of British businessmen agreed that “the single market has benefited my business,” a lower approval rate than from any EU country bar Italy.

Neil O'Brien, campaign director for Vote No, which is likely to act as an umbrella group for those hostile to the constitution, attributes this change to the increasing burden of EU regulation. Disappointment with the single market's apparent failure to stimulate growth in the euro-zone has also contributed to disenchantment. The result is that even American and Japanese businessmen are now more likely to extol the merits of the single market than the Brits.

The problems that the “no” campaign faces—over-zealousness and working out how best to spend all its money—are luxuries by comparison. Although the campaign has not, as Denis MacShane,

the minister for Europe, claimed in a recent interview, been “spending literally hundreds of millions”, Vote No and its affiliates do have rich and committed backers. It has already started to use this advantage to influence floating voters.

Vote No reckons that hostility to the constitution is U-shaped. Older voters are the most hostile, often expressing a wish to withdraw from the EU altogether. Middle-aged voters, many of whom voted for British membership of the European Community in 1975, in the hope of heading off economic failure and isolation, are the least hostile to the constitution. Then opposition climbs again among younger voters. But, unlike the oldies, they tend not to favour total withdrawal from the EU.

Within this U-shape, there are enough undecided voters to offer hope to both sides. Vote No has identified women aged between 25 and 35, who are broadly supportive of Europe but worry about the constitution, as a key constituency. It has tailored its message accordingly, running an advert before “Bridget Jones: the Edge of Reason”, a film about an endearingly gormless diarist constantly pursued by good-looking men. The advert is fronted by a man with the high cheekbones and shoulder-length hair of an Italian footballer, who says “‘yes’ to Europe and ‘no’ to the constitution.” “We went on an office outing to see the film,” says Mr O'Brien, “and we found ourselves sitting right in the middle of our target audience.”

The “yes” campaign hopes to win over floating voters by pointing out that the constitution and Europe go together, and that a “yes” vote is more likely to preserve relations with Europe as they are already. The timing of referendums in other Eurosceptic countries is important here: if they come after Britain votes, that will help to create the impression that voting “no” will lead to isolation. The “yes” campaign also hopes to play the barmier end of British Euroscepticism against more moderate opponents of the constitution.

The fissile UK Independence Party should help them here. Its highest-profile member, the permatanned former television presenter Robert Kilroy-Silk, recently stalked out. The more airtime given to politicians like UKIP's deputy leader, Michael Nattrass—who recently compared Britain's position in the EU to Chechnya's within Russia, adding that “we will have to fight our way out”—the happier the “yes” campaign will be. “There is lots of mileage in pointing out that the hardcore ‘no' voters are complete mentalists,” says a pro-European in a foreign policy think-tank.

To distance itself from the little-Englanders, Vote No plans to draft in Eurosceptics from elsewhere in Europe. In December, the various “no” campaigns held their first pan-European meeting in, er, Brussels. Vote No promises a parade of European businessmen and politicians from the EU's new member countries to persuade British voters to vote against the constitution. The “yes” campaign, meanwhile, will try hard to sound as patriotic as possible, raising the entertaining prospect of Europhile internationalists shunning anyone with a foreign-sounding surname or a funny accent, while British Eurosceptics defer to German businessmen.

If the government can wake the same anxieties about isolation last seen after the disastrous Suez expedition in 1956, the current weakness of the “yes” campaign may not matter. Certainly Mr Blair's advisers think that public opinion could be turned around in a couple of months, perhaps by using Britain's EU presidency this year to show off about how everything in Brussels is going Britain's way. But those all-important Bridget Joneses may have already made up their minds by then.

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Home ownership

Just in time for the crash

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From The Economist print edition

Why some people think plans to raise home ownership are misconceived

TONY BLAIR was playing his favourite game this week. The prime minister's latest wheeze is to set a target for home ownership. At present 70% of homes in Britain are owner-occupied. Mr Blair told the *Financial Times* that he would like this to rise to 80% in ten years' time.

The reason Mr Blair is so keen to increase the number of home owners is that he thinks people who have no housing equity to draw on in their lifetimes or to inherit from parents are likely to stay at the bottom of the socio-economic pile. Whether the target is achievable is another matter. In the past ten years, the home-ownership rate in Britain has risen only gradually from 66% to 70%. Raising it to 80% would mean 2.5m more households becoming owner-occupiers.

Mr Blair's aspiration sits uneasily with the more modest ambitions of John Prescott, who is in charge of housing. Mr Prescott worries about reducing the stock of social housing. He unveiled his schemes on January 24th, the same day that Mr Blair revealed his target. His “five-year plan” for England included several measures to increase cheap home ownership. However, they fall far short of the more radical changes that would be needed to raise the home-ownership rate to 80%.

One initiative is to encourage cheap new homes, built for around £60,000 on government land. If, say, the land cost were an additional £40,000, the first-time buyer would acquire a 60% stake in the property. The government hopes that the scheme will spur building firms to cut construction costs. But, it will help only 15,000 first-time buyers over five years—an annual rate of 3,000.

Another new measure could affect many more people. Since 1999, the government has run a small-scale scheme called Homebuy, in which people limit their purchase to 75% of the house price and the social landlord advances 25% as an equity loan. The government wants to extend this to as many as 300,000 tenants in social housing, who could purchase a share of 50% or more in their home. However, only about 15,000 of them are expected to take advantage of the opportunity each year.

Altogether, then, Labour's new measures should assist about 18,000 households a year. Existing programmes, including one for “key” public-sector workers in expensive parts of the country, take the total number who will be helped to 30,000 a year. However, households are forecast to grow by 190,000 a year, dwarfing the impact of the government's efforts.

But if the home-ownership rate doesn't rise that much in the years ahead, is that necessarily a bad thing? Although people generally say they would like to own their homes, owner occupation is not ideal for everyone. It is unsuitable for young people who are highly mobile. And it is risky for many people on erratic earnings.

Christine Whitehead, a housing economist at the London School of Economics, cautions against

unrealistic ambitions to raise the home-ownership rate, which, she says, is stabilising in several countries. “If anything, the government should be striving to increase the share of the private rented sector,” says David Miles of Morgan Stanley, author of a report to the Treasury on housing finance.

What's more, governments are notorious for their bad timing. The drive to get people into home ownership is as good a sell signal for the housing market as any forward indicator. If house prices enter a long period of decline or stagnation, poor people who take up the government's offers could find themselves in possession of a burden, not an asset.

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Channel Tunnel

In a hole

Jan 27th 2005
From The Economist print edition

More bad news from Eurotunnel

AS AN example of Anglo-French technical prowess, the Channel Tunnel is impressive. The American Society of Civil Engineers thinks it a wonder of the modern world. But as an example of modern financial wizardry, it has been less successful.

Last week Eurotunnel, the firm that owns and runs the tunnel, released a trading update for 2004. Car traffic fell by 8% and coach traffic by 12%. Lorry traffic stayed unchanged, but market share declined. Revenue fell from £560m to £538m. The company blamed low-cost airlines and poor market conditions.

That is grim news for the shareholders, who are mainly French. Annoyed by their disappearing investments, and egged on by Nicolas Miguet, a share tipster, failed presidential candidate and convicted fraudster, they removed the company's board in April last year and replaced it with a group of French businessmen. The newcomers binned plans to cut prices and buy the Channel Tunnel Rail Link, a high-speed line planned to run from London to the tunnel entrance. Instead, they hope that a new pricing structure and a cost-cutting programme can save the company.

Eurotunnel posted an operating profit of £70m in the first half of 2004, but the company is buried beneath a £6.5 billion debt pile. Just paying the interest converted that £70m profit into a £76m loss. Its huge debts are a result of the wildly over-optimistic forecasts that the project was built around: the tunnel cost twice as much as planned, and the rise of the low-cost airlines and the resilience of the ferry companies mean that far fewer people use it than even the pessimists predicted.

There is more financial pain to come. As *The Economist* went to press, the board was trying to get a waiver from its creditors to allow it to begin debt restructuring talks. At the end of the year the company will lose its ability to issue credit notes for interest payments that it cannot meet. In 2006, agreements expire that guarantee a minimum income from Eurostar (an independently-run passenger service) and the freight companies, who pay Eurotunnel to use its track. With traffic far below expected levels, that could wipe £40m off Eurotunnel's revenue. And, under current plans, the company must begin capital repayments on half its debt in 2007.

Some shareholders hope for a government bail-out. But that's unlikely: leaving aside the problem of which set of taxpayers would foot the bill, state aid is banned in the project's founding treaty. A debt-for-equity swap with the banks that financed the project is more likely, but would dilute the shareholders' stake further. Without some kind of deal, the banks may have to step in directly. But they'd rather not: lending money to grandiose projects is their business, not running them.

Public finances

Who's going to pay for it all?

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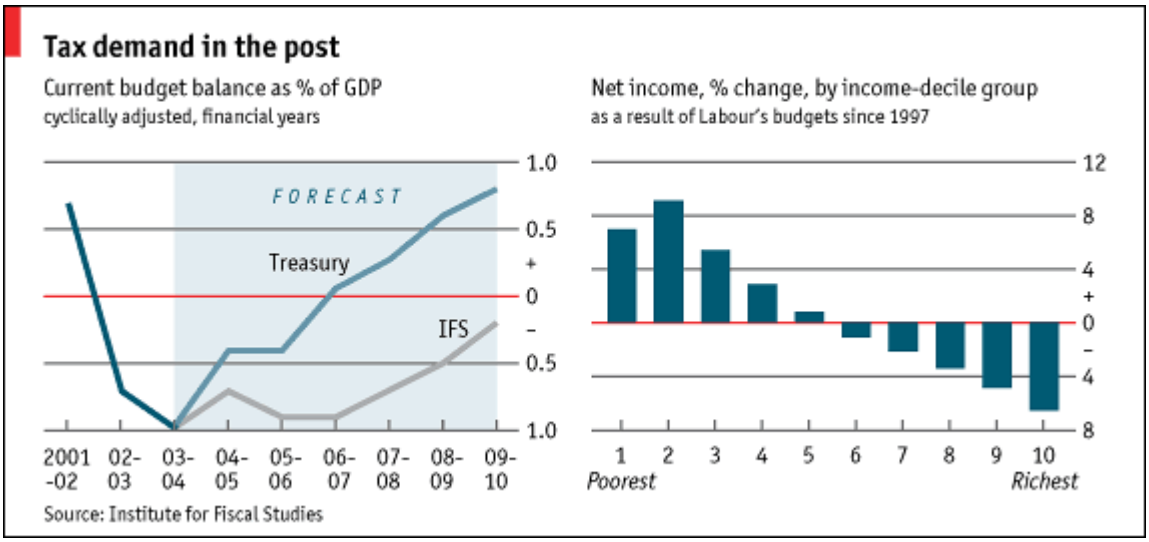
The tough times start next year

GORDON BROWN'S next budget, which he will present in a few weeks' time, comes only a couple of months before the expected election date. It is therefore expected to be a soothing document. Governments that are short of cash do not do exciting budgets before elections. Those looking forward to an interesting budget, according to the Institute for Fiscal Studies, which published its version of the nation's fiscal position on January 26th, will have to wait until next year. They can expect a big tax demand.

The IFS has looked hard at Mr Brown's sums and thinks they don't add up. It calculates that a tax increase of £13 billion—equivalent to 1% of GDP—will be needed in April 2006 to put the public finances on to a more sustainable footing.

Mr Brown aims to meet his "golden rule" of borrowing only to invest. Current revenues must equal or exceed current spending over the economic cycle.

Happily for Mr Brown, the Treasury's forecasts show that he will meet the rule. Adjusting for cyclical conditions, the current budget will be just in surplus when the next economic cycle starts in 2006-07, as the Treasury expects (see chart). The surplus will then steadily increase.



Unhappily for Mr Brown, the IFS sees a bleaker future. It forecasts that the cyclically adjusted current budget will be in deficit when the next cycle starts in 2006-07. And it will stay in the red over the following three years.

The gap between the two forecasts does not arise from differences about the economic outlook. The IFS adopts the Treasury's economic assumptions. Nor does it arise from a disagreement about the amount of tax revenue that's needed in the years ahead. The point at issue is whether that revenue can be achieved with or without a tax-raising budget.

The Treasury is forecasting that the tax take will rise from 38.3% of GDP in 2004-05 to 40.5% in 2009-10 without tax increases. The IFS points out that this increase of 2.2 percentage points is about double what would normally occur thanks to “fiscal drag”, which takes place as earnings growth pushes taxpayers into higher tax brackets. It is forecasting a still hefty increase in the tax take to 39.8% of GDP without tax-raising measures. But that still leaves a gap, which will require tax increases of £13 billion in the 2006 budget.

There are no prizes for guessing who will have to foot the bill. The IFS has worked out the winners and losers from all Mr Brown's measures on taxes and benefits since 1997 (see chart). The pattern, which includes council tax since this is heavily affected by Treasury decisions, speaks for itself. The big gainers are the poorest 20% of the population. The richest have been clobbered hardest. What's more, the pattern of income redistribution has become much more marked in the past four years as Mr Brown has increasingly played Robin Hood.

In Labour's first term, Mr Brown was initially prudent and built up a big treasure-chest. In Labour's second term, the chancellor has run down this surplus and borrowed heavily in order to finance a spending spree. A third term will bring a reckoning, and it promises to be a painful one as voters have to pay for Labour's free-spending ways.

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Efficiency savings

Compared with what?

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The way planned efficiency gains have been calculated casts doubt on their value

WHEN fiscal times are hard, waste is a favourite target for politicians, but this government has made a bigger deal than most of its determination to save money to fund spending. To emphasise the importance it placed on this issue, it asked Sir Peter Gershon, when he was head of the Office of Government Commerce, to locate potential efficiency savings. Sir Peter identified the scope for efficiency gains of 2.5% a year, which would build up to an annual saving of £21.5 billion in 2007-08.

The sum is impressive, but the benchmark against which these savings are to be measured has remained something of a mystery. Until now, that is. Speaking on January 24th at an Institute of Economic Affairs conference, Sir Peter clarified that the benchmark is one in which the government makes no prospective efficiency gains at all.

This raises the question whether the government is just hyping efficiency gains that would have happened anyway. Take the health department, which accounts for almost a third of the total savings. In 2007-08, up to half of this £6.5 billion will come from better use of staff time resulting from IT investments. “Presumably a big chunk of these gains would have occurred whether or not there had been an efficiency review,” says Colin Talbot, professor of public policy at Nottingham University.

Furthermore, there is nothing novel about the government setting efficiency targets. In 2002, for example, the health department was set a “value for money” target of 2% a year for the three years to 2005-06. As Sir Peter himself says, private-sector companies aim to make much larger annual efficiency gains.

Still, those troubled by the idea that the government has duped the public need not worry. The public learned long ago to ignore government claims that it was saving money by slashing waste.

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Bagehot

Fear of foreigners

Jan 27th 2005
From The Economist print edition

The Tories, like the government, are being dishonest about immigration

Get article background

EVER since Enoch Powell's rant about rivers flowing with blood, immigration has been dangerous ground for Tories. If they go there, they earn the hatred of the liberal intelligentsia and risk losing the votes of all sorts of aspiring ethnic-minority voters whose determination to better themselves should make them natural Tories. If they don't, they ignore an issue likely to appeal not just to their natural constituency but also to voters they might hope to steal from Labour.

Partly thanks to the impeccably liberal instincts of Oliver Letwin, the former shadow home secretary, the Tories have held off immigration recently. But when David Davis took the job, it was inevitable that they would succumb. And, just as inevitably, when they raised the issue this week, Trevor Phillips of the Commission for Racial Equality accused them of encouraging racists, while Maeve Sherlock of the Refugee Council described their plans as “dangerous, ill-thought-out and hugely irresponsible”.

The idea that the Tories should not be talking about immigration is clearly daft. Immigration is regularly among the top four issues that voters mind about, according to MORI, an opinion pollster. A few days ago, the “Today” programme on BBC Radio 4 held focus groups in Watford, a Labour-held marginal just north of London, to find out which issues most concerned female voters. The younger group mentioned the war, but would probably not bother to vote. The older group of women, all of whom had voted Labour in the last two elections, started off by saying that what mattered most to them was public services, until one shyly confessed that what really worried her was immigration. In a flash, all the others agreed. A week earlier, viewers of the ITV show “Vote For Me” were overwhelmingly endorsing Rodney Hylton-Potts as the “people's politician”. Rodders, as he likes to be known, advocates zero immigration.

Raising immigration at the last election—which William Hague, the then leader, did as a last resort—did not do the Tories much good. Yet things may be different this time, largely because the government is so vulnerable. It has dealt with immigration neither competently nor frankly.

The frankness deficit lay in the government's failure to tell voters that it acquiesced in a huge increase in the number of workers being given permission to enter Britain. During Labour's first term, the number of migrants from outside the European Economic Area (the EU plus other rich European countries) granted settlement doubled. That was not, contrary to popular belief, because of an uncontrollable flood of asylum-seekers. Most of the rise was accounted for by new workers and dependants of existing workers—categories within the government's control. Yet ministers did not tell people what was happening or why. In Labour's 2001 manifesto, there was just one reference to the “positive contribution” made by people from abroad.

Asylum policy, meanwhile, was mired in incompetence. When David Blunkett became home secretary in 2001, we now know (thanks to his biographer, Stephen Pollard) that he was horrified by “the giant mess” he had inherited from his predecessor, Jack Straw. His difficulties were exacerbated in February 2003 when the prime minister promised to cut the number of asylum-seekers in half within six months. The commitment, which Mr Blunkett furiously described as “undeliverable”, could be met only by easing visa restrictions on countries such as Romania and Bulgaria. When a whistle-blower in the demoralised and inefficient Immigration and Nationality Directorate described what was going on, the immigration minister, Beverley Hughes, was forced to resign. The policy was perfectly sensible, but the row made the government's claims to be “getting on top of the problem” appear hollow.

All of this suggests that the Tories are right to think that the government has left it fertile ground to occupy. By and large, Michael Howard, the Conservative leader, who is the son of Romanian Jews who fled to Britain to escape the Nazi death camps, has chosen his words carefully. Nor are the policies he and Mr Davis have come up with much more odious than anything the government has already contemplated or may announce when it presents its latest ideas on the subject in a few weeks' time. Tony Blair has ridiculed the Tories' claim to be able to process asylum-seekers in friendly third countries, but the government's unusually muted response shows how rattled it is.

Yet the Tories are not being wholly straightforward either. By implying that the increase in foreigners is the consequence of an overwhelming tide of asylum-seekers, they are guilty of the same sort of dishonesty as the government.

Good immigrants, bad immigrants

As far as the British public is concerned, there are immigrants and immigrants. A YouGov poll commissioned by *The Economist* last month found that 74% believed that too many immigrants were coming into the country. But voters were not in the least bit bothered about people who came explicitly to work. What caused the grumbling was not the idea that immigrants might be competing with them in the job market, but that asylum-seekers (who are forbidden to work while their claims are being laboriously processed) are cheats and scroungers who are overloading public services. The sort of immigrants flooding into Britain, in other words, are the sort the British claim to like.

It is wrong to attack the Tories for raising immigration as an election issue, but it is fair to criticise them for the way they have done it. The biggest thing that has happened in Britain in the past decade has been the arrival of foreign workers, both well-off and poor, who have transformed business, culture, food and much else. Some people like them and some people don't; but they aren't, for the most part, the bedraggled asylum-seekers and fruit-pickers the Tories would have people believe.

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European textiles

The sorry state of fashion today

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AFP

From high fashion to the high street, Europe's rag trade is being torn to shreds

THIS week Paris was abuzz with the biannual ritual of the city's high-fashion shows. Giorgio Armani opened the series on January 24th, the Italian designer's first ever show in Paris. Almost louder than the buzz of the shows, however, was the industry's fretting over its own future. Europe's fashionistas are asking how long high fashion can survive. With a dwindling client base and copies rapidly available from clothes chains with quick production cycles, it has become almost impossible to make money out of custom-made garments.

Givenchy, Yves Saint Laurent, Versace and Valentino are all making losses—only Chanel is thought to make money. After failing to make a profit for years, Ungaro is up for sale, and on January 25th Moët Hennessy Louis Vuitton (LVMH), a luxury-goods firm, sold Christian Lacroix, another loss-making brand, to American duty-free retailers for a “symbolic” price. Prada has parted company with Helmut Lang after persistent losses. Ten years ago, more than 20 houses held Paris shows; today only a handful can afford to carry on.

Europe's rag trade has been in trouble now for more than five years. Luxury-goods groups reliant on glamorous names keep high fashion alive. Valentino, for example, is owned by Marzotto, Italy's biggest clothing and textile group; Yves Saint Laurent belongs to Pinault-Printemps-Redoute, a French rival to LVMH.

Further down the fashion chain things are equally dire. Mass-market producers cannot afford sustained losses. Medium-sized and small companies in France, Italy and Spain are cutting production or moving it abroad. Some have merged or tried to cut costs by lowering the quality of their products. Dozens have already gone under; many more are fighting for survival.

The effects of China

The main cause of the mass market's troubles is competition from China. Producers cannot match its low labour costs: the effect can be devastating, says Didier Grumbach at the Fédération Française de la Couture, France's main fashion association.

And it can only get worse. Since January 1st world trade in textiles has been freed of all restrictions, and members of the European Union (EU) are expecting a flood of Chinese imports. At the moment the EU is the world's leading exporter of textiles and the second-largest exporter of clothing. The industry employed 2.7m people in 2003 and had a turnover of more than €225 billion ($250 billion). But the EU's imports of Chinese textiles and clothing almost doubled between 2001 and 2003, partly as a result of a phase-out of quotas that began ten years ago. The World Trade Organisation (WTO) predicts that within two years China could control about 50% of the world's textile market.

Home to more than half of Europe's textile companies, Italy stands to suffer most from China's new freedom. It has some 50,000 textile companies clustered in Biella, Como and other regions. They are small, often family-run firms employing an average of ten people. Nearly two-thirds of their production is exported.

Many of these firms have already felt the pinch. Fratelli Piacenza, a cashmere company in Biella, is moving production to lower-wage countries. Other firms have reduced production and cut workers. Yet more jobs will go this year. “Italy is now going through the crisis that happened in France about eight years ago,” says Mario Boselli, boss of the Camera Nazionale della Moda, Italy's big fashion association.

In France, dozens of firms went out of business between 1993 and 2003, when about one-third of the industry's jobs were lost. Today more than 60% of French brands are produced abroad. Kindy, a sock-maker, started to move part of its production to North Africa and Portugal in the 1990s. Now it is planning to produce even more cheaply by moving 30% of its production to China over the next three years.

The French and Italian fashion associations have long been bitter rivals, but on January 17th Messrs Grumbach and Boselli agreed on a plan designed to soften the shock caused by the ending of textile quotas. They intend to co-operate in the battle against counterfeiting and to fight for further measures to stem the flow of low-quality textile imports.

The industry's most effective lobby, however, is Euratex, a trade association based in Brussels. Over the past few months it has argued for “safeguards”, controversial instruments used to justify stemming the flood of Chinese imports. Safeguards were built into the agreement that America signed with China in November 1999 as part of China's accession to the WTO. Turkey decided on January 9th to use safeguards on 43 categories of Chinese textiles, and Argentina recently imposed similar quotas on textile imports from China. Euratex is sure there will be a case for invoking safeguards in the EU soon. In 2002 and 2003 imports of anoraks from China increased three or four times while prices fell by 75%, says a spokesman. (Quotas for anoraks ended earlier than those for other products.)

Peter Mandelson, the EU trade commissioner, has so far been cold towards the idea of re-imposing restrictions. The European Commission says it is working on guidelines for the imposition of safeguards, but it has been saying that for the last three months, grumbles Thierry Noblot of the Union des Industries Textiles, the French industry's main lobby group.

China is thinking of imposing restrictions itself: setting minimum prices on some clothing exports in addition to export duties of 2-4% on some textiles. But neither measure is likely to have much effect. European firms need to continue restructuring for the new textile world, where they must focus on quality and innovation, their only competitive advantages over China. Italy's Biella is spending €2.8m on a marketing campaign to promote “the art of excellence”.

The need for innovation and excellence is also the best argument for the survival of Europe's haute couture. Now that Mr Armani has at last been to the Paris shows, he must return again and again.

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Monsanto

Lord of the seeds

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A good move to buy the world leader in vegetable seeds

MONSANTO, the world leader in genetically modified (GM) grains and oilseeds, is buying a second blade for its plough: California-based Seminis, the leader in vegetable seeds. Seminis made a small loss in 2003-04 and news of the $1.4 billion buy cut Monsanto's share price by 6%. But it may yet prove a smart move.

Seminis brings four benefits. One, a huge range of new crops—almost any vegetable you can name and some that you can't—to join Monsanto's maize, soya and others. Two, an extra $550m-a-year turnover as Monsanto's focus shifts from its $3.2 billion (but slow-growing) herbicide business into seeds and GM, whose $2.35 billion sales in its latest reported 12 months were 24% up on a year earlier. Three, a worldwide network, including a new operations centre in China and a two-year-old one in India, two huge potential markets. Four, a non-GM image.

Seminis was founded in 1994 by Alfonso Romo, a Mexican tycoon, as part of his Savia group. At the time he dreamed of GM, but Seminis made heavy losses, and in 2003 he sold to Fox Paine, an American private-equity firm that is now profitably selling out. Mr Romo's string of acquisitions created a firm that is widely (and wisely) decentralised. Much of its research and sales lies in Europe. Facing European fears and rules, however, Seminis has not tried to push GM there.

Indeed, it sells very little GM anywhere: its many new varieties arise from advanced use of the old technique of cross-pollination. The link with Monsanto, suggests Gillian Turco of Rabobank, a Dutch bank that specialises in agribusiness, might, paradoxically, be exactly what the GM cause needs. Biotechnology does not mean just GM. Give consumers something as unusual as Seminis's mini-watermelon, downsized—but not by GM—to suit one person, not eight, and they may realise they are already in the biotech era, and over time lose their fear of GM.

Well, perhaps, though enemies of GM argue persuasively that Europeans already know very well that their food results from cross-breeding, but still think GM a step too far. Monsanto itself says it will carry on with Seminis's traditional technology, though it might use GM in the longer term. GM farming is spreading rapidly outside Europe, but, given the hassle that Monsanto's present GM crops have met, that slow approach may be wise.

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eBay

Give us your tired computers

Jan 27th 2005
From The Economist print edition

A new plan to recycle old PCs may forestall regulation

THE computer industry is built on the assumption that PCs and electrical devices are replaced every few years. It is a strategy that leaves tons of electronic junk in its wake. Over 130,000 PCs are replaced every day in America alone, and only a tenth or so are recycled. Ingredients such as cadmium, mercury and lead can do terrible things to people and places. In Europe, such e-waste is the fastest growing type of refuse, accounting for 8% of all municipal rubbish.

Regulators have taken note. In California, legislation to levy a surcharge on computer sales to defray recycling costs took effect this month. (A European Union directive in 2003 requires equipment-makers to recycle, but it has not yet been implemented in national laws.) Manufacturers such as IBM, Dell and HP have been trying to deflect further legislation by introducing their own recycling programmes. But they have had limited success—partly because they tend to charge for recycling unwanted machines. Apple's price for taking back one of its computers in America is $30.

Now eBay, the world's leading online auction business, has come up with an innovative way to encourage people to sell, donate or recycle their old machines over the internet. A web-based program “reads” the redundant computer's components and gives its specifications (like its memory and processor speed). Owners can then ascertain the value of their old PC, put it up for sale and get a special mailing kit to simplify shipping. The site also makes it easy to donate a PC to charity or get it to a nearby recycler.

The scheme is no altruistic act of corporate social responsibility. It began as an attempt by Patrick Jabal, manager of the site's computer and networking category (which does $2.5 billion-worth of transactions a year), to drum up more business.

Watching people's buying and selling patterns on eBay's site, Mr Jabal, an entrepreneur with an MBA from Harvard Business School, noticed an unmet demand for cheap, old PCs. Though they were plentiful in the closets of eBay users, listing and selling them was problematic. So, in order to increase their supply on the site, he set out to overcome the difficulties that users had—often no more than an inability to remember the vital statistics of the machine they had been using.

Then he stumbled on the issue of waste and realised that the company could do even more. “It was a way to meet a business objective, help the environment, and help confused consumers,” he says. It may also turn out to be a clever market-based way to avoid more regulation.

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South African mining

All that's gold does not glitter

Jan 27th 2005
From The Economist print edition

At today's prices, South Africa's mines barely make money

LAST year should have been a great year for gold-mining companies. And for some it was: in dollars, gold was fetching about $410 an ounce a year ago, way above the $250-or-so low of February 2001. It soared briefly above $450 as November ended, and even now, after a rapid slide, is still about $425. Fine if your costs are in dollars. But what if they are in rand?

That was a different (and sorry) tale for any gold-miner in high-cost South Africa. After a dim 2003, the gold price leapt to just over 3,000 rand an ounce in mid-January 2004. But as the rand soared—from about seven to the dollar in January to little above six in July—gold slid to about 2,500 rand an ounce, about where it is today.

That is no problem for a global giant like Newmont, which has no South African mines. No huge one either for giant AngloGold Ashanti (born of a merger last April), based in Johannesburg but with mines worldwide. But it is awkward for South African firms mining little or no gold elsewhere to offset their woes at home—and for one miner in particular: Harmony.

Last October, Harmony launched an impudent, all-share bid for its grander compatriot Gold Fields, and the bid battle is still limping expensively along. The declared logic of the deal was to create the biggest gold producer in the world, and a national champion for South Africa. But the reality was simpler. Harmony had lost money for five quarters on the trot; Gold Fields, overall, makes money. Harmony mines little outside its home country; Gold Fields mines quite a lot. And South Africa's real trouble is not just that the rand is strong, but that its gold is costly to extract.

South Africa's mines typically are deep; two miles or so, some of them. Easily accessible ore near the surface was hauled away decades, even a century, ago. Working deep underground costs far more than the open-pit mining common elsewhere, and South Africa's low wages do not make up for that, even as against first-world mining. Its mineworkers' union is strong, and recent pay rises have been generous.

In the third quarter of 2004, Newmont was mining gold in Indonesia at a cash cost of about $115 an ounce; in Peru, $140; in Uzbekistan and Turkey, $170; in New Zealand, $205; in Australia, at varying sums from $225 to $310; and in Nevada, $290. Newmont expects $200 at a big mine due to open in 2006 in Ghana. These figures of course reflect varying currencies, wage levels and ore quality as well as geology. But few are near AngloGold Ashanti's $350 or so in South Africa over the same period (but at today's dollar/rand rate and including some costs that the firm omits); let alone (at the same rate), the $385 of Gold Fields there, or Harmony's $410. Non-cash operating costs, mainly depreciation, add $30-60 to all these figures.

AngloGold Ashanti this week reported a 2% quarterly cut in rand costs. Gold Fields and Harmony, reporting next week, may have similar news. Even so, unless gold rises, and/or the rand slides

significantly, some South African mines clearly face trouble. Harmony's bid for Gold Fields has justifiably made headlines, but for the industry it is really a sideshow.

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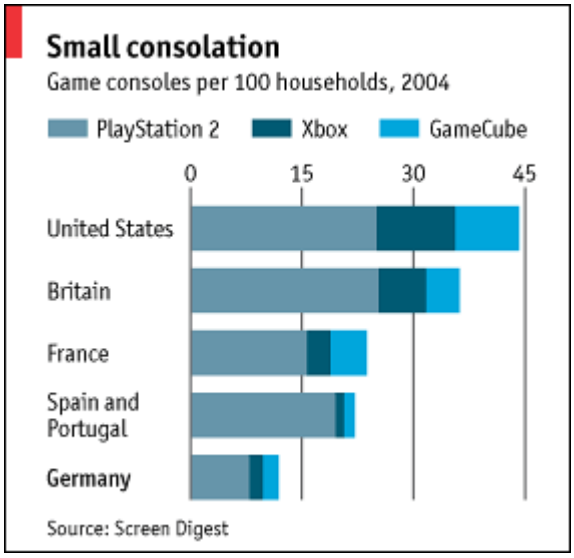
Video games

Reasons to be playful

Jan 27th 2005
From The Economist print edition

Germans are beginning to enjoy gaming



“WHAT IS wrong with Germans?” asks Gerhard Florin, European boss of Electronic Arts, the world's largest games-maker, as he laments his compatriots' lack of enthusiasm for video games. Games consoles are twice as popular in France and Spain, and around four times as popular in America and Britain (see chart), as they are in Germany. Whatever the reason, it is not technophobia: Germans are keen users of mobile phones and broadband internet connections.

The ailing German economy is partly to blame, says Nick Parker, an independent games analyst, but the main reasons are cultural. Germans spend less than other Europeans not just on games but on other forms of entertainment too. In 2003, they went to the cinema an average of 1.8 times, compared with 2.8 visits per person in Britain, 2.9 in France and 3.4 in Spain, according to figures from Screen Digest, a market-research firm. Similarly, German spending on DVDs was €1.4 billion ($1.7 billion) in 2004, compared with €3.4 billion in Britain, which has a much smaller population. Germans have a different attitude to entertainment, says Mr Florin. They feel they need excuses even for going to a football match.

More important is the unusually tight control that German parents maintain over their children's consumption of media and technology, says Mr Parker. An industry rule-of-thumb, he says, is that a 12-year-old German boy is as media-savvy as a nine-year-old British boy. Selling more games, then, involves changing the attitudes of parents. “We have to convince German mothers that playing games instils necessary life skills,” he says.

That could be tricky. The educational value of the internet is obvious; that of gaming, less so. Even in game-mad America, the idea that it might be educational (by promoting strategic thinking, for example) is not taken very seriously.

Yet there are signs of change. In 2002, Electronic Arts overhauled its German marketing strategy in an attempt to convince opinion-formers of the merits of gaming. Sales of Sony's PlayStation 2 console grew there last year by 11%, faster than anywhere else in Europe except Switzerland. The proportion of homes with PlayStations rose from 6% to 8%. Raising the popularity of gaming in Germany to the levels seen in America and Britain could increase sales of games software by $2 billion a year. No wonder Mr Florin is keen for his countrymen to become more playful.

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Wireless internet

World domination postponed

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The prospects for WiMax technology have been hugely overhyped

TO HEAR some of its more enthusiastic proponents you might conclude that WiMax, an emerging wireless-broadband technology, was about to take over the world. WiMax is akin to a long-range version of the popular Wi-Fi technology that allows computers close to a small base-station to surf the internet without wires. Whereas Wi-Fi's range is limited to a few tens of metres, WiMax can, in theory, work over tens of kilometres, allowing huge areas to be blanketed with wireless coverage. Hence the claims that WiMax will bring internet access to the 5 billion people who currently lack it, or that it will render expensive “third-generation” (3G) mobile networks redundant.

The reality, however, is that WiMax has been hugely overhyped. Despite claims by several firms that they are offering WiMax technology today, the actual number of WiMax devices on the market is precisely zero. That is because the WiMax Forum, a standards body that oversees the technology and ensures that gear from different vendors works together, has yet to certify any devices with the WiMax label.

On January 24th it announced that pre-certification testing will begin in July, which means that the first WiMax devices will be available only at the end of the year, six months later than expected. So far, equipment-makers can offer only “pre-WiMax” or “WiMax-ready” equipment which will, they promise, be compatible with WiMax devices when they appear.

The hype is now giving way to much scepticism about the technology's prospects. “I don't think it's completely hot air, but it won't live up to its early promise,” says Jagdish Rebello of iSuppli, a market-research firm. WiMax, he says, will chiefly be used by telecoms firms in rural areas, to plug holes in their broadband coverage.

In urban areas WiMax does not make sense, since it will be uneconomic compared with cable and DSL, argues Kenneth Furer, an analyst at IDC. “It's not going into New York, Los Angeles or London,” he says. It is also too expensive for use in the developing world, at least for the time being, since early WiMax access devices (which must be fixed to the outside of a building) will cost around $500; other forms of wireless link, such as mobile-phone networks, will remain a cheaper way to connect up remote villages.

Fervent believers in WiMax, chief among them Intel, the world's largest chipmaker, believe the technology will take off when it can be incorporated into mobile, rather than just fixed, devices. The next version of the WiMax standard, which has yet to be finalised, will support mobile access, provided the technology can be made small and energy-efficient enough to fit into laptops and handheld devices. Alan Murphy, a WiMax specialist at Intel, is optimistic that WiMax chips for laptops will be available in late 2006 and that they will consume only 10% more power than today's Wi-Fi chips.

Intel regards WiMax as a promising source of future growth. Intel chips power a majority of the world's PCs, and the company dreams of establishing a similar franchise in mobile devices, a far larger market. Equipment-makers, for their part, are counting on Intel to deliver: WiMax will become widespread only if the price of access devices falls, which in turn depends on the availability of cheap, mass-produced WiMax chips. But Intel has a poor track record in shipping wireless chips on time. And it is still unclear how much demand there will be for mobile WiMax. Carlton O'Neal of Alvarion, the biggest maker of fixed-wireless gear, notes that the mobile-phone base-station market is over $55 billion a year. “The big dream is to cover the planet with WiMax and get to a $50 billion market,” he says. It certainly is a big dream—but so far, that is all it is.

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Saab

A turn-up for the Swedes

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Saab cars are about to be made outside Sweden

THEY are as Swedish as bagpipes are Scottish. But just as there are more pipers in the Carolinas than in old Scotia, so Saabs are being blown away from the homeland. The next Saab will probably be built in Germany, so aggravating legions of college professors in tweed jackets with leather arm patches who buy the brand simply because it is anything but German.

General Motors (Saab's parent company) is getting tired of losing hundreds of millions of dollars in Europe with its Opel and Vauxhall brands. Dogged by dullness and variable quality, they have been losing money for years. Where once GM (and Ford) could count on European profits to plug their American losses, now their European bits just add to the general misery.

GM's purchase of Saab five years ago was supposed to give it a posh brand with better margins. But the Americans left the Swedes to go their own sweet way, and they created yet more losses. Now that is to stop. Fritz Henderson, GM Europe's tough new boss, has no intention of letting failure in Europe block his path to the top of the company.

Part of the solution to GM Europe's problem is for Saab to share body parts and engines with Opel, at the risk of damaging the Swedish company's reputation for being quirky and upmarket. Economies of scale could be found by sending the two different marques down one production line.

Mr Henderson set up a competition between Opel's Russelsheim factory in Germany and Saab's Trollhattan factory to see which should have the task of building the next Opel/Saab mid-sized model. To the delight of Carl-Peter Forster, Mr Henderson's right-hand man, both plants' proposals offered striking productivity improvements. Russelsheim, for instance, promised a reduction in manufacturing costs (compared with the cost of existing models) of no less than 50%. The Swedish percentage cut in costs was somewhat less, but from a lower base.

Mr Forster says the point of the exercise was not to decide which plant would have to close, but to see how far each could go in matching east European costs. Even the losing plant in the competition, he says, stands a fair chance of landing production of another of GM Europe's upcoming 45 new models. So it looks as though Germany (where closing a plant is a nightmare) has won the new model and is set to make the first truly non-Swedish Saab.

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Corporate governance in Germany

A model out of time?

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Reform of the way German companies are run is proceeding slowly

Get article background

GERMANS are increasingly questioning the way that their large public companies are run. State prosecutors are investigating why Volkswagen kept a pair of parliamentarians on its payroll for years, while last week a Frankfurt court ruled that a reluctant Deutsche Bank must disclose how much it pays to members of its elite executive committee. This week, Werner Seifert, the chief executive of Deutsche Börse, owner of Frankfurt's stock exchange, came under attack for ignoring his shareholders' views in his eagerness to buy the London Stock Exchange.

At the heart of German corporate governance lies its unusual two-tier board structure. Meetings of its non-executive supervisory board are, says one veteran director, little more than time-wasting theatre. There can be as many as 30 directors sitting round a boardroom table. In any company with more than 2,000 employees, up to half of them might be workers' representatives who see their main task as saving jobs in Germany, even when a majority of their company's workforce is based abroad.

Co-determination (by workers and management), a guiding principle of German corporate governance since 1951, is proving a hindrance these days when speed and flexibility are essential to global competition. Yet, until a few months ago, any talk of its abolition was taboo. Many bosses pretend to like it. In some cases their job depends on keeping on good terms with workers' representatives who sit on the board that hires and fires them.

Moreover, top German executives look forward to moving on to their company's supervisory board. Heinrich von Pierer is stepping down as CEO of Siemens to assume duties as chairman of its supervisory board. That will mean that at 17 of the top 30 German listed companies, the chairman of the supervisory board is a former chief executive.

A government-sponsored body, the Cromme Commission, published a code of corporate governance in May 2003, and recommended that a maximum of two former executives should sit on a company's supervisory board. A draft EU corporate-governance code recommends a five-year gap between executive- and supervisory-board duties at the same company—in recognition of the risk that former executives may defend bad business decisions that they previously initiated.

Supervisory board members are supposed to control and advise the executive board (the *Vorstand*). “They need to be professional, to be sparring partners for the *Vorstand*,” says Heinz Evers, a partner at Kienbaum, an executive-search firm. But they are not well motivated. A recent study by Spencer Stuart, another executive-search firm, found their pay ranged from €5,000 ($6,530) a year to €102,000. The workers' representatives, appointed by the unions, have to give 95% of anything that they are paid above a modest €3,500 a year to the Hans-Böckler-Stiftung, a

trades-union foundation.

In recent years German companies have been “doling out unwarranted pay” to their executives, says Christian Strenger, a former CEO of DWS Investment and a member of the Cromme Commission. According to a recent study by a human-resources consultancy, not only are German executives the best paid in Europe, but the component of their bonuses linked to short-term targets is higher even than that of their counterparts in America. This has put pay and performance out of line. In one case, while DaimlerChrysler's market value fell by 60%, its top executives' pay rose by 40%.

No government in the foreseeable future is likely to tackle co-determination and two-tier boards head on. The best that can be hoped for is that shareholders, rating agencies and the media will increase the pressure for boards to be more transparent, and thereby more answerable to their shareholders. Since a press campaign last year, more companies have undertaken to follow a Cromme Commission recommendation to reveal individual executive's pay: 23 out of the 30 companies on Germany's main stockmarket index, the DAX 30, have complied or said they intend to. But it is clear that some are doing so only under duress.

Deutsche Bank had devised a way round the requirement: in 2002 it set up a group executive committee that was independent of its two-board structure. While the bank's 20-strong supervisory board watched over its four-man executive board (whose salaries are declared), the committee got on with running the bank without revealing its executives' remuneration. Last week, however, a court ruled that the pay of these executives too must be revealed—a rare victory for transparency.

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Face value

Breaking into a man's world

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Reuters

The new boss of the Sabanci group chose to wear trousers instead of a wedding dress

TURKISH industry is dominated by two vast family businesses, both of which have recently handed over their top jobs to a new generation of 40-somethings. The Europeanised Koc group passed the reins to Mustafa Koc, the eldest of the chairman's three sons, in 2003. But before Sakip Sabanci died last year, he let it be known that he wanted neither of his two brothers nor any of their numerous male offspring to succeed him as head of the far more traditional Sabanci family business. Rather, he chose his niece, Guler. It was a choice that he had been hinting at for at least a decade.

Turks were astonished by the appointment of a woman to such a powerful post in what remains a patriarchal society. But none was more surprised than Ms Sabanci herself. As her uncle lay dying in an Istanbul hospital, she recalls thinking that she would quit the business. “I could not envisage staying on without him,” she says.

Running a sprawling conglomerate with annual sales of $12 billion and interests ranging from banking to cars, and from energy to food, is a challenging task that comes at a particularly challenging time. In December, EU leaders finally agreed to begin accession talks with Turkey on October 3rd this year. Over the coming decade, Turkish companies will need drastically to alter their often unorthodox business practices if they are to thrive within the EU. Although TUSIAD, Turkey's powerful association of businessmen, currently headed by one of Guler's cousins, strongly supported the country's attempt to join the EU, many of its individual members fear the abolition of protectionist policies behind which they have prospered for decades.

Sabanci Holding went through a big restructuring of its operations before Turkey signed a customs union with the EU in 1996. The process was designed to prepare it for global competition. Ms Sabanci says that the EU straitjacket can only benefit honest Turkish businesses. For a start, it will help constrain the country's vast black economy (estimated at anything up to 50% of GDP), making competition for companies like Sabanci “much fairer”. More companies will be compelled to pay taxes and follow health and safety regulations.

The EU's decision to start accession talks is also expected to enthuse foreign investors for a country that they have to date noticeably shunned because of decades of chronically high inflation, political instability and massive corruption. That gloomy image is slowly being altered under the group of mild Islamists who have been running Turkey for the past two years. And slowly the world is noticing.

This newly stable environment has prompted Ms Sabanci to look for new alliances with foreign partners, a strategy that the group excels at. She herself masterminded its first joint-venture, with DuPont in 1987, setting up a $100m nylon-yarn producer in the port city of Izmit. The group's joint-venture with Toyota, which the Japanese car manufacturer is said to be well pleased with, was launched in 1994 as a platform for exporting Corollas to the rest of Europe. Last year it captured 6.7% of the highly competitive local car market.

Ms Sabanci says acquisitions are also on the cards. They may include Telsim, Turkey's number-two mobile-phone operator. It was taken over by the government after its owners, the Uzan family, stole billions from their foreign partners, Motorola and Nokia, and the company was forced into bankruptcy.

Behind her unconventional lifestyle—she lives alone and mixes with painters and popstars—lies a tough, conservative businesswoman who takes only carefully calculated risks; one reason, say her business associates, why her uncle anointed her as his successor. Some of her male cousins were so offended that one of them, Demir Sabanci, is rumoured to have sold all his shares in the company last month, because he could not stomach being bossed by a woman.

From sharecropper to shareowner

Ms Sabanci's first brush with industry was at the age of three, when her grandfather Haci Omer, a rags-to-riches former cotton sharecropper in the southern province of Adana, took her to the family's textile factory there. Ms Sabanci's parents divorced when she was eight and left her in the care of her grandfather. “He always told me that one day I would wear trousers, drive a car and work in the factory.”

And that is what she did: her career began 27 years ago at the family's tyre factory in Izmit. She resisted her grandmother's unrelenting demands to “see me in a wedding dress” choosing, as she puts it, “my work instead.” When not working she keeps an eye on the wine she launched in 1999, under the label “G”, the same year she launched what she calls “my big baby”: Sabanci University. The university has matured rather better than the wines—it is already counted among Turkey's best privately-owned colleges. Some 40% of its students are offered free tuition, subsidised by the $20m a year that the university gets from the Sabanci group.

“Tough” and “unpretentious” are the words that employees most frequently use to describe Ms Sabanci, a reformed chain smoker with a gravelly Janis Joplin-like voice. Her toughness came to the fore recently when she withstood pressure from the state to fire Halil Berktay, an eminent Ottoman historian at the university. He had dared to suggest that Turkey's Armenian minority may have been slaughtered in large numbers by Ottoman forces during the first world war.

Her late uncle similarly angered the authorities when he called for more rights for Turkey's Kurdish minority. “His greatest lesson to me,” says Ms Sabanci, “was to be a free thinker, to be tolerant, honest and fair.” Those who know her say it is a lesson that she has learnt well.

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Toyota

The car company in front

Jan 27th 2005 | NAGOYA
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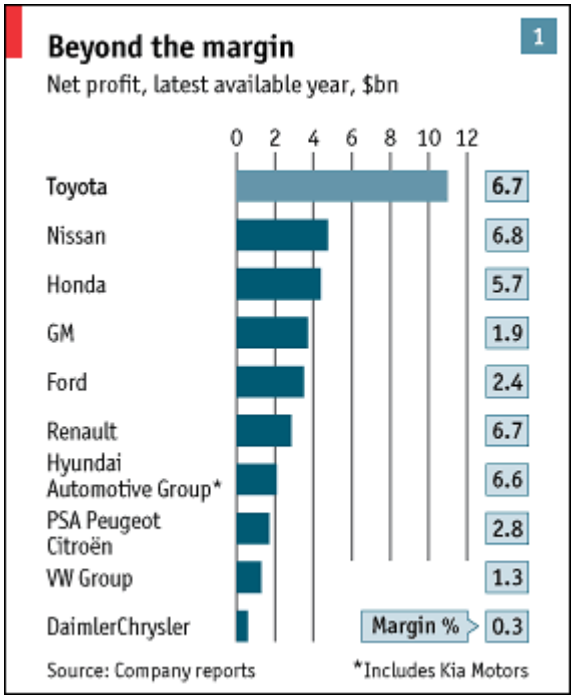
AP

Toyota makes lots of money and is overtaking General Motors to lead the world's car industry. What is the secret of its success?



THERE is the world car industry, and then there is Toyota. Since 2000 the output of the global industry has risen by about 3m vehicles to some 60m: of that increase, half came from Toyota

alone. While most attention over the past four years has focused on a spectacular turnaround at Nissan, Toyota has undergone a dramatic growth spurt all round the world. Japan's industry leader will soon be making more cars abroad than at home. It has overtaken Ford in global production terms and is set to pass Chrysler in sales to become one of America's Big Three. In an industry strewn with basket cases, where hardly any volume producer makes a real return on its capital, Toyota is exceptional in that it consistently makes good returns (see chart 1).

Toyota's ebullient chairman Hiroshi Okuda has made little secret that he wants the company to win 15% of the global car market, snatching leadership from General Motors. Having reached Global Ten (10% of the world market) Mr Okuda has his eyes focused on his new goal. “It's just to motivate employees,” says Fujio Cho, Toyota's more downbeat president. “Somehow news of the banners in our factories leaked out,” he says disingenuously, as if you could keep such a secret after it has been blazoned to 264,000 workers around the world.

Market capitalisation says it all. Toyota is worth more than the American Big Three put together, and more than the combination of its successful Japanese rivals, Nissan and Honda. Last year Nissan may have outperformed Toyota in terms of operating margin, but over the long haul it has been the provincial powerhouse from Aichi prefecture near Nagoya that has consistently shown the way.

First, of course, it taught the modern car industry how to make cars properly. Few had heard of the Toyota Production System (TPS) until three academics in the car industry study programme run by Massachusetts Institute of Technology (MIT) wrote a book in 1991 called “The Machine that Changed the World”. It described the principles and practices behind the “just-in-time” manufacturing system developed at Toyota by Taiichi Ohno. He in turn had drawn inspiration from W. Edwards Deming, an influential statistician and quality-control expert who had played a big part in developing the rapid-manufacturing processes used by America during the second world war.

At the core of TPS is elimination of waste and absolute concentration on consistent high quality by a process of continuous improvement (*kaizen*). The catchy just-in-time aspect of bringing parts together just as they are needed on the line is only the clearest manifestation of the relentless drive to eliminate *muda* (waste) from the manufacturing process. The world's motor industry, and many other branches of manufacturing, rushed to embrace and adopt the principles of TPS.

In the process American and European cars went from being unreliable, with irritating breakdowns, leaks and bits dropping off in the 1970s, to the sturdy, reliable models consumers take for granted today. In real terms car prices may only have edged down over the past two decades compared with the drastic reductions seen in personal computers and all consumer-electronics goods. But the quality, content and economy of today's cars is incomparable with what was on offer 30 years ago. The main credit goes to the Japanese, led by Toyota. High petrol prices drove American consumers to buy economical Japanese imports; high quality kept them coming back. Europeans, too, were quick to see the attraction of cars that seldom broke down, unlike the native varieties. When trade barriers were erected, the Japanese built their plants inside them. Toyota may have been slower than Honda or Nissan to expand abroad, but its manufacturing method gave it an advantage once it did so.

So Toyota's success starts with its brilliant production engineering, which puts quality control in the hands of the line workers who have the power to stop the line or summon help the moment something goes wrong. Walk into a Toyota factory in Japan or America, Derby in Britain or Valenciennes in France and you will see the same visual displays telling you everything that is going on. You will also hear the same jingles at the various work stations telling you a model is being changed, an operation has been completed or a brief halt called.

Everything is minutely synchronised; the work goes at the same steady cadence of one car a minute rolling off the final assembly line. Each operation along the way takes that time. No one rushes and there are cute slings and swivelling loaders to take the heavy lifting out of the work. But there is much more to the soul of the Toyota machine than a dour, relentless pursuit of perfection in its car factories.

Another triumph is the slick product-development process that can roll out new models in barely two years. As rival Carlos Ghosn, chief executive of Nissan, notes in his book “Shift” (about how he turned around the weakest of Japan's big three), as soon as Toyota bosses spot a gap in the market or a smart new product from a rival, they swiftly move in with their own version. The result is a bewildering array of over 60 models in Japan and loads of different versions in big overseas markets such as Europe and America. Of course, under the skin, these share many common parts. Toyota has long been the champion of putting old wine in new bottles: over two-thirds of a new vehicle will contain the unseen parts of a previous model.

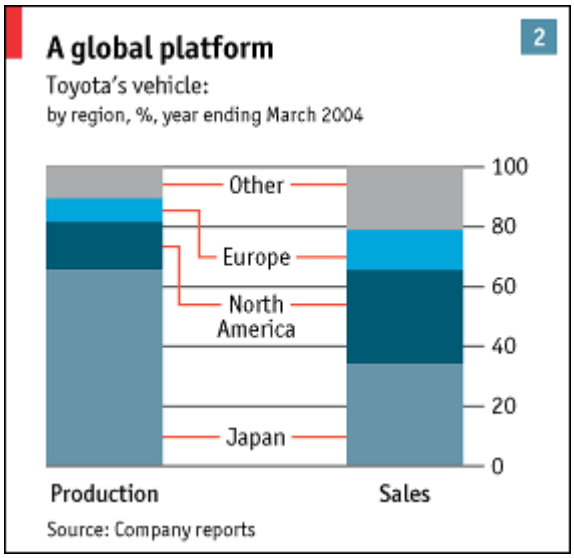
Pleasing Mrs Jones

Spend some time with Toyota people and after a time you realise there is something different about them. The rest of the car industry raves about engines, gearboxes, acceleration, fuel economy, handling, ride quality and sexy design. Toyota's people talk about “The Toyota Way” and about customers. In truth, when it is written down the Toyota creed reads much like any corporate mission statement. But it seems to have been absorbed by Japanese, European and American employees alike.

Mr Cho thinks something of the unique Toyota culture comes from the fact that the company grew up in one place, Toyota City, 30 minutes drive from Nagoya in central Japan, where the company has four assembly plants surrounded by the factories of suppliers. In this provincial, originally rural setting, Toyota workers in the early days would often have small plots of land that they tended after their shift. Mr Cho, who made his career in the company by being a pupil of Mr Ohno and becoming a master of production control, thinks that the fact that Toyota managers and their suppliers see each other every day makes for a sort of hothouse culture—rather like Silicon Valley in its early days.

Jim Press is boss of Toyota's sales in North America. He left Ford in frustration 35 years ago, because he did not think it handled customer relations properly and he suspected that the upstart Japanese company making its way in the American market might do better. He was right. Toyota shares a production plant in California with GM. Identical cars come off the line, some badged as GM, the rest as Toyotas: after five years, according to one study by Boston Consulting Group, the trade-in value of the Toyota was much higher than that of the American model, thanks to the greater confidence people had in the Toyota dealer and service network.

Mr Press talks with a quiet, almost religious, fervour about Toyota, without mentioning cars as such. “The Toyota culture is inside all of us. Toyota is a customer's company,” he says. “Mrs Jones is our customer; she is my boss. Everything is done to make Mrs Jones's life better. We all work for Mrs Jones.”



But not even the combination of its world-leading manufacturing, rapid product development and obsessional devotion to customer satisfaction is enough to explain Toyota's enduring success. There is one more ingredient that adds zest to all these. Tetsuo Agata doubles as general manager of Toyota's Honsha plant in Toyota City and as the company's overall manufacturing guru. The magic of Toyota's winning culture was summed up for him by an American friend who observed that Toyota people always put themselves “outside the comfort zone”: whenever they hit one target, they set another, more demanding one. That relentless pursuit of excellence certainly explains much of what has been happening to the company in recent years, at home and abroad.

The strain of going global

Life started changing for Toyota when the economic bubble burst in Japan at the start of the 1990s. First it had to work hard to improve its competitiveness as the yen strengthened. Mr Okuda, president in the mid-1990s, launched a programme of cost-cutting to make the company's exports competitive even at a yen level of only 95 to the dollar. When costs fell and the yen subsequently weakened, Toyota reaped a double reward.

But the company also had to face up to a car market at home that slumped from nearly 6m sales a year to just over 4m. And Toyota has had to respond to renewed competition in its domestic market, after an aggressive push by Honda and the revival of Nissan. One reaction by Mr Cho to tough competition at home has been a further round of cost cuts that have helped Toyota re-build market share in Japan from 38% in the mid-1990s to 44.6% last year, helped partly by windfall sales after the implosion of Mitsubishi Motors.

But European imports of Volkswagens, BMWs and Mercedes cars have mopped up 7% of the Japanese market, mostly for premium models, and forced Toyota to introduce its luxury Lexus brand into Japan. Until now, cars that Americans and Europeans have known as Lexuses have been sold as plain old Toyotas in Japan. Now Mr Cho has decided, as part of a wider reorganisation of Toyota's distribution network, to sell these vehicles separately with the Lexus badge and support from their own up-market retail outlets.

One of Toyota's strengths has been its army of privately owned car dealers, long organised into five competing channels, each one more or less specialising in different parts of the range. The multiplicity of distribution channels arose simply because of the rapid growth of the Japanese market and Toyota sales from the 1970s onwards. But in February 2003 Toyota administered what

was called the Valentine's Day shock. It streamlined the number of channels down to four, including a new one aimed at the young people turned off by mainstream Toyota's staid image. (It is having to go even further in America with a separate sub-brand called Scion to appeal to young consumers.)

Like all car companies Toyota in Japan has had to get used to a fragmentation of the market, which means there are no longer huge runs of a few bestselling models. The boss of the Tsutsumi plant, where the firm's trendy Prius hybrid cars are made, recalls the good old days when all they had to do was churn out half a million Camrys and Coronas. Today's lines have been adapted and made flexible so that no fewer than eight different models can be manufactured simultaneously. The Prius—despite its revolutionary engine—still has to share an assembly line in the Tsutsumi plant with several conventional models.

Seeds of success

Making all these changes at home is relatively easy compared with Toyota's biggest challenge, now that it has set itself the goal of making more cars outside Japan than at home. Apart from seeking to switch production to exports, Toyota also chased growth outside Japan by building three more plants in North America and two in Europe, starting with Derby in Britain, followed by Valenciennes in the north of France. Between 1993 and 2003, overseas production more than doubled to 2m units, while in Japan it declined from 3.5m to 3m before recovering in the later years to its old level, boosted by exports; about half of domestic production is exported.

This globalisation process has transformed the size and shape of Toyota. In 1980 Toyota had 11 factories in nine countries; in 1990 it had 20 in 14 countries; today it has 46 plants in 26 countries. In addition, it has design centres in California and in France on the Côte d'Azur, and engineering centres in the Detroit area and in Belgium and Thailand.

Although Japan remains its biggest single market, sales topped 2m in North America for the first time last year, and in Europe Toyota is passing through the 1m mark, with 5% of the market, after a long period of slow growth. The opening of plants in Turkey and France and the introduction of the European-designed Yaris small car have done much to make Toyotas more appealing to Europeans, while in America its entry (not without a few hitches) into the enormous market for pick-up trucks and sport-utility vehicles has been responsible for its steady march to beyond 10% of the market. It is now breathing right down the neck of Chrysler.

AFP

Mr Cho acknowledges that such international growth and globalisation is the biggest change happening to the company. He sees his greatest challenge as maintaining Toyota's high standards in such areas as quality while it grows so fast across the globe. For Toyota has only recently started to transform the way it is run to make itself a truly global company rather than a big exporter with a string of overseas plants. Its top-heavy all-Japanese board has been drastically slimmed and five non-Japanese executives, including Mr Press, have been made managing officers, which means that they sit on the executive committee in Tokyo, but are also left free to run their overseas operations on a day-to-day basis without deferring to head office. For Toyota, that is a big step away from centralised rule by Toyota City.

Another leap has been the creation of a Toyota Institute, not just for training Japanese managers, but also for developing groups of executives from all over the world. The centre is expressly

modelled on the Crotonville Centre that has played such a big part in the success of General Electric. By having squads of managers moving through development courses, head office can keep tabs on the potential of its people, whilst ensuring that they are thoroughly steeped in Toyota's way of doing things, whether it be in manufacturing, retailing, purchasing and so on.

Let us Prius

But globalisation and the rapid growth of production now in places such as China is also straining the learning process further down the hierarchy. Toyota has a flying squad of line workers who move around the world to train locals at new factories or move in to help out when there is a model change going on. These line supervisors train local workers. Toyota has also made astute use of joint-ventures to ease the strain of manning overseas operations: apart from its original one with GM in California, Toyota now has another with a local company in Turkey, with PSA Peugeot Citroën in the Czech Republic and in China, which is the fastest-expanding part of Toyota, in line with the country's rapid motorisation. Toyota reckons that it will learn much about purchasing more effectively in Europe from its French partner in the new joint-venture, which is preparing to unveil a budget car for the European market at the beginning of March at the Geneva Motor Show.

But the company is finding there are limits to the number of Japanese managers and foremen who are prepared to work as expatriates, either on a temporary or permanent basis. So it has opened a Global Production Centre in a former production area in Toyota City. Here, on a given day you can see Filipino and Chinese workers being taught how to assemble Toyota cars. To get round obvious language barriers the instruction makes heavy use of video recordings and inter-active DVDs, a sort of automated, virtual version of watching how Nelly does it.

The best gets better

Perhaps the best single example of Toyota managers' aversion to taking it easy in the comfort zone is back where it started—in the mysteries of the TPS. Mr Agata, one of the firm's manufacturing experts, regards his job as inculcating the virtues of the TPS in a younger generation. But he has concluded that the company has to raise its game. “We have always proceeded by steady improvement,” he says. “But now we need to make step changes as well to keep ahead.” That means finding radically different ways of manufacturing things like bumpers or doors, reducing the number of parts, and developing new machines to form parts more economically.

As GM's bonds sink towards junk status, and as Japanese carmakers steadily overhaul America's Big Three, it must be a chilling thought that Detroit's nemesis is working on ways to improve its performance. No wonder one GM planner mused privately that the only way to stop Toyota would be the business equivalent of germ warfare, finding a “poison pill” or “social virus” that could be infiltrated into the company to destroy its culture.

What else could stop Toyota? Soon it will have the scale to outgun GM. A technological revolution will not threaten it, since Toyota is leading the way with hybrid electrics en route to full-scale fuel-cell electric cars. Consumer preference for exciting designs? Toyota has shown that it can play that game: there is a stylish edginess in recent models such as the Prius, Yaris, the new Avensis and even its venerable LandCruiser SUV. At least the man from GM put his finger on the key to Toyota's success. Provided its culture can be sustained as it goes from being an international

Japanese company to a global one, then Toyota's future seems secure.

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Asbestos in America

A bid to bypass the lawyers

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Alamy

Can the new Congress cut through America's asbestos-litigation mess?

SOCIAL SECURITY may be the third rail of American politics, but asbestos liability is surely the Gordian knot. For three decades, Congress has pondered how to deal with the masses of lawsuits brought against companies by workers exposed to asbestos, a cancer-causing fibre. Hundreds of thousands of claims are pending in America's courts, with total costs forecast to reach $200 billion. Dozens of firms have been bankrupted by lawsuits, many of which were brought by people who were not ill. But the problem is so complex that lawmakers have got nowhere.

Now Congress is redoubling its efforts to cut through the knot. Arlen Specter, the new chairman of the Senate Judiciary Committee, plans to introduce a bill next week that would create a $140 billion trust fund to compensate victims. Companies that are the target of lawsuits would stump up the bulk of the money, $90 billion. Insurers would pay $46 billion. The last few billion dollars would come from trust funds set up by firms already bankrupted by asbestos claims. Victims would give up their right to sue for damages. The idea is to cut out the lawyers and to relieve the overloaded courts.

The awfulness of asbestos is not in dispute. More than 100,000 American workers (300,000, say trial lawyers) have died after being exposed to it. Until the 1970s asbestos was widely used to insulate buildings. But breathing it can cause mesothelioma, a cancer, or other lung problems. Mesothelioma can take decades to develop, so new cases keep flooding in.

Some liability is absorbed by insurance companies. If the dispute is left to the courts, American

insurers could end up paying as much as $65 billion, according to a 2001 projection by Tillinghast, an actuarial firm. By comparison, the industry paid out less, about $40 billion, after the attacks of September 11th 2001. Other companies have to pay too, because they either are self-insured or have exhausted their insurance limits. Claimants' first targets were asbestos manufacturers, which were accused of failing to disclose the dangers early. Most of these went bust long ago. Lawyers now go after companies that used asbestos or distributed products containing it, or that bought companies that had done these things. Often a claimant will sue 60 entities at once, including bankrupt manufacturers' trusts.

The problem is that much of the money is going to the wrong people. About two-thirds of the total is awarded to those who do not have cancer (though they might later develop it), according to a 2002 study by RAND, a think-tank. Essentially, many people are being compensated for their fear of getting sick. Lester Brickman, a law professor at Yeshiva University, in New York, told President George Bush recently that “out of approximately 850,000 claimants since asbestos litigation began, perhaps 600,000 of these are largely baseless claims”. Worse, more than half of the cost of litigation is paid to lawyers or spent on administration. All this means that there is less money to pay for future claims by the truly ill, especially from companies toppling into bankruptcy.

The dreaded details

Will Mr Specter be able to deliver reform? Luckily, he is not starting from scratch. A year ago Bill Frist, leader of the Republican majority in the Senate, tried and failed to bring a bill to the Senate floor. He subsequently entered negotiations with Tom Daschle, then the Democrats' leader. These talks produced the $140 billion figure. Labour and trial lawyers, who generally back Democrats, had wanted more; business and insurers had lobbied for less. The two leaders also agreed on standards to determine who is sick and should be paid quickly, and that claims should be processed by the Department of Labour.

Still, because the devil is in the details, Mr Specter can expect as much trouble as Mr Frist encountered last year. He should find out how tough it is next week, when his bill, whose introduction was delayed this week, is due finally to be unveiled. One controversy swirls around how much people with different grades of illness will get: should smokers who develop lung cancer but show no asbestos-related symptoms despite exposure get $150,000, $500,000, or something in between?

Trickier still is the question of how much different companies will be required to pay into the fund. The bill is expected to create a formula under which companies with big past liabilities will contribute more. Larger companies may also have to pay more than smaller ones with similar liabilities. Every firm is convinced that it will be asked for more than its fair share. Small companies fear that the scheme will bankrupt them. Big companies worry about paying disproportionately. This month Exxon Mobil, DuPont and others wrote to Mr Specter to complain that their payments to the trust fund would “substantially *exceed*” the costs they expect to incur through the courts. The fund, they argue, would also render perfectly good insurance useless. Firms, such as Halliburton, that have already settled with claimants will not take part in the fund.

Insurers are also concerned about paying too much, especially because they will have to fork out a lot early in order to get the fund going. One thorny matter concerns Equitas, a reinsurer set up to deal with the pre-1993 liabilities of Lloyd's, the London insurance market. About 55% of its claims are for asbestos, the vast majority of them in America. It would be one of the fund's biggest contributors, though paying less than 5% of the insurers' total.

Equitas fears that the bill will discriminate against it, by allowing other companies—but not Equitas—the chance to ask for relief if they believe their payments to the fund to be too onerous.

American insurers retort that it is fair to treat Equitas differently because of the peculiar structure of Lloyd's. Scott Moser, Equitas's chief executive, says that his firm has adequate reserves and is prepared to pay its share, but that “somebody will have to come to England” if the fund demands more than Equitas has available.

And what if the trust fund cannot pay all legitimate claims? To insurers and business, this may be the most worrying question of all. Mr Specter's drafts indicate that he will allow victims to return to the courts if the fund goes bust. Executives are horrified, because they will not know for certain if they can really close the books on asbestos. There are, however, expected to be restrictions designed to prevent claimants from jumping around the country to find the friendliest state courts.

With so many special interests—and dollars—at stake, some observers put the bill's chances of passing at less than 50-50. Still, Mr Specter is determined to get it through committee and on to the Senate floor next month. He may be helped by the fact that the Republicans have a larger majority in Congress than last year. More important, the cause of tort reform has the president's strong support; Mr Bush toured the country earlier this month to call for curbs on asbestos, class-action and medical-malpractice lawsuits. If Mr Bush can help Congress fix America's asbestos mess, more power to him.

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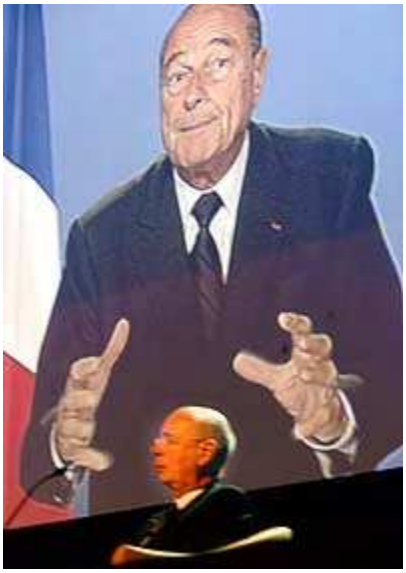
Jacques Chirac's tax proposal

Tobin or not Tobin?

Jan 27th 2005 | DAVOS
From The Economist print edition

That is the latest question facing Davos Man

Reuters



Jacques on the box

Get article background

THERE is nothing like saving the world to bring out the competitive streak in a politician. So when Tony Blair decided to use the World Economic Forum in Davos to unveil his messianic agenda for 2005 and beyond, the British prime minister managed to provoke not only (as usual) his finance minister and main domestic rival, Gordon Brown, but also his senior competitor in continental Europe, Jacques Chirac, the president of France. In the end, the bitterly cold weather and a plan to visit Auschwitz prevented Mr Chirac from making a personal appearance in the Swiss mountain resort. Even so, via a video-link, Mr Chirac made a serious attempt to steal Mr Blair's thunder.

As this year's head of the G8 wealthy industrial nations and, from July, president of the European Union, Mr Blair wanted to enlist the support of Davos men and women for his crusade against the twin evils of climate change and extreme poverty, especially in Africa. But in a hastily arranged speech delivered only hours earlier, Mr Chirac seemed to attempt to grab from Mr Blair (and Mr Brown) the intellectual lead on at least the second of those issues, by proposing new “international taxes or levies” to be used directly to finance development. For a start, he said, there should be an experimental levy to finance the fight against AIDS.

To what would this “international solidarity levy”—which Mr Chirac said could raise $10 billion a year—be applied? He had several suggestions: a very low rate of tax on international financial transactions, perhaps; a contribution by countries that maintain bank secrecy (hello, Switzerland) to compensate for the tax evasion they thereby facilitate; a tax on the use of fuel in transport by air or sea (which surely contributes to climate change); or even, say, a $1 levy on each of the 3 billion plane tickets sold each year worldwide.

This would not be, insisted Mr Chirac, that old French favourite, the “Tobin tax”, as proposed by the late Nobel prize-winning economist, James Tobin. But in the case of the levy on financial transactions, that is exactly what it would be. Such a tax has well-known disadvantages. It wrongly assumes that no cost would arise from the reduced liquidity in financial markets that would surely result. It also requires that all governments co-operate in levying the tax (unlikely, you might suppose); otherwise financial transactions would simply shift to non-co-operating countries.

The business leaders gathered in Davos were mostly unimpressed, especially by the proposed levy

on air travel, which would hurt one of the world's financially weakest industries. (Mr Chirac should instead stop subsidising Air France and use the money to reduce poverty, muttered some.) Mr Blair's proposals to increase aid, relieve debt and focus primarily on those poor countries ready to help themselves went down much better. Noting merely that Mr Chirac had proposed ways to “raise further money”, Mr Blair gave warning of the danger of an “international community with competing agendas” which would only “help the political art of grandstanding”. Could Mr Blair, no mean grandstander himself, possibly have been thinking of a certain French leader?

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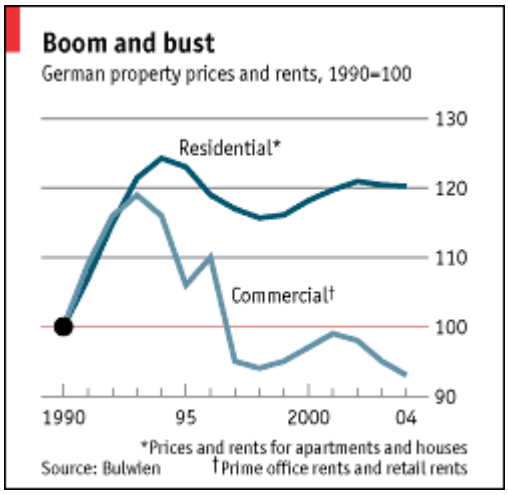
German banking

Still not pretty

Jan 27th 2005 | FRANKFURT
From The Economist print edition

A large Bavarian bank prepares itself for marriage



AT GERMANY'S second-biggest bank, HVB Group, nasty surprises have become something of a habit. On January 21st it declared that it was writing off €2.5 billion ($3.3 billion) of property loans, and that this would—no, no, honestly, we mean it this time—clean up its portfolio. Analysts and investors were unimpressed. The write-off is merely the latest episode in a saga of losses and revaluations since HVB was formed by a merger of two big Bavarian banks in 1998. The merger quickly led to the discovery of a DM3.5 billion (these days, €11.8 billion) hole, mainly in eastern German property loans.

Dieter Rampl, HVB's eternally optimistic boss, insists that this is the end of the bad news, and that his bank can concentrate on its profitable areas. Alas, even those—retail and corporate banking—are not doing well. The group's one jewel, bought in 2000, is Bank Austria, a successful retail and investment bank with a network of subsidiaries in central Europe. A quarter of Bank Austria's shares were floated on the Vienna stock exchange in 2003. The share price has since doubled.

Even after the latest write-off, however, HVB has too many loans and not enough capital. In the past two years it has sold some of its best assets, such as Norisbank, a small but successful retail bank, and that stake in Bank Austria, just to raise cash. It has potential, boasting 5% of the retail banking market in Germany and nearly 15% in Bavaria, but lacks the strength to expand. It is a clear takeover candidate, albeit for a brave buyer. At least, says a source close to the bank, after the latest clean-up “the poison pill is slightly less poisonous.”

Any purchaser would have to deal with sagging profits, a domestic workforce of 26,000 that (this being Germany) would be hard to trim and a portfolio of German property loans of nearly €100 billion. The German economy, although looking a tad healthier, is still weak. The property market has been moribund since a boom after reunification in the early 1990s (see chart). HVB spent last year waiting for things to get better. They might not.

Nevertheless, at least two banks might be interested: Italy's UniCredit, which also has operations in central Europe and for several years has sought a German acquisition; and Deutsche Bank, Germany's biggest bank, which, some say, needs to reassert itself at home. To buy HVB, though, Deutsche would have to forget its declared aim of a 25% return on equity. Rating agencies would certainly punish any acquirer.

HVB is not just waiting to be swallowed. In November Mr Rampl reshuffled his board, appointing Johann Berger to take over corporate banking and property, and Christine Licci, former head of Citigroup's German retail-banking operation, to revamp the retail business. HVB, like many German private banks, had neglected retail banking, where returns have long been thin. However, under Ms Licci Citi proved that it can be profitable, with a return on equity of 54% in 2003.

Mr Berger has been at HVB before. He returns from Hypo Real Estate, which was spun off in 2003. The product of a merger of five mortgage-bank subsidiaries, it has done well despite the dire state of the German market, largely because much of its portfolio is foreign. The spin-off, however, left HVB with all the German commercial and retail loans against which it had raised its own funding.

Mr Berger's best-known achievement at Hypo Real Estate was the sale of €3.6 billion of patchy property loans to Lone Star, an American private-equity group. HVB could do with such expertise. It has sold some of its duff loans, mainly in the form of asset-backed securities to institutional investors. But Dresdner Bank, owned by Allianz, a big insurer, has shown that huge amounts can be shifted in this way. It has managed to reduce €35 billion of German and international assets parked in an “institutional restructuring unit” to around €11 billion; €8 billion of German loans have been sold or cancelled.

Lone Star, which bought around €6.8 billion of German loans recently, some from Dresdner, is now seeking a German bank. It already owns banks in Japan and South Korea. It is thought to be in talks to buy Mitteleuropäische Handelsbank, a small subsidiary of NordLB, a public-sector lender. HVB might be too much for Lone Star to swallow—but not, perhaps, for someone else.

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Savings accounts in Italy

Pass

Jan 27th 2005 | ROME
From The Economist print edition

The Italian government lets a deadline slip. Does it matter? No one knows

RELAXED and flexible: that sometimes seems to be the Italian approach to money-laundering. The government has already drastically eased rules on false accounting, granted an amnesty for the illegal accumulation of assets offshore, tried to obstruct international judicial co-operation and is a laggard in ratifying a common European arrest warrant. It has now given a six-month reprieve to holders of bearer passbooks, which, although generally used by unsophisticated savers, are also an easy means of transferring money illicitly.

An anti-laundering law enacted in 1991 put a limit of 20m lire (about €10,000) on all cash transactions, but set no penalties for passbooks containing sums above that amount. A decree issued early last year to implement a European Union directive laid down severe penalties where such accounts contain more than €12,500: fines of 20% of balances up to €50,000 and 40% above that. The decree should have come into effect at the end of January but on January 21st the government put back the deadline to July 31st.

There is clearly a problem, but neither the Bank of Italy, the country's central bank, nor the Italian banking association can put figures on it. One estimate says there are around 10m extant bearer passbooks, many of them hidden away, perhaps even forgotten, under mattresses, in wardrobes and in safe deposit boxes. Their total balance might be as high as €100 billion and there are likely to be thousands of passbooks that break the law, says a banking expert.

As financial instruments go, bearer passbooks are rather old-fashioned, favoured by pensioners, perhaps as a way of dodging inheritance taxes, and by southerners, wary of anything that smacks of sophistication or of being too far from cash. Crooks have also had a liking for them. Bearer passbooks have turned up among sequestered Mafia assets, notes Antonio Ingroia, an anti-Mafia magistrate in Palermo.

However, by slipping the deadline for holders to bring balances in their passbooks within the limit, the government is, at least on this occasion, only helping the uninformed. With the banks, it has failed to spread the word about the change in the law. Widows and orphans would have been the ones hit by the penalties. “The *mafiosi* have certainly put their passbooks in order by now,” remarks Mr Ingroia.

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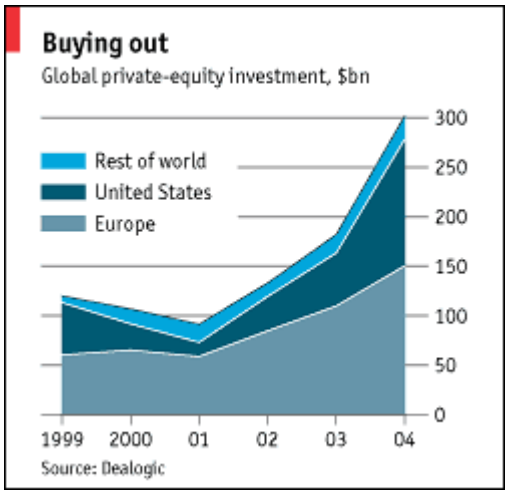
Private equity

Size matters

Jan 27th 2005
From The Economist print edition

Buy-outs are all the rage



RECENTLY, private-equity funds have been doing a record volume of business. Perhaps that explains why rumours that Goldman Sachs was poised to launch a $7 billion fund made headlines this week (the bank refused to confirm or deny the report). Such a fund would be the biggest run by an investment bank, and one of the biggest of all. Whether or not it goes ahead, the recent growth in the number and size of investments by private-equity firms shows that, for now at least, there is still plenty of appetite for their services.

Last year, according to Dealogic, a research firm, private-equity funds worldwide invested $302 billion, up by two-thirds from 2003 (see chart). America saw the fastest rise, with the total value of deals more than doubling, from $53.5 billion in 2003 to $127.8 billion. European investments grew by 37%, even though the number of deals rose only slightly. In Japan, however, private-equity activity fell by more than half, to $3.3 billion.

Not only is there more money sloshing around, but also deals of over $1 billion are becoming commonplace. The number of transactions of this magnitude soared to 79 in 2004, up from 42 in 2003. Last year's biggest deals included the $4 billion purchase by Kohlberg Kravis Roberts of PanAmSat, a satellite company. Intelsat, another satellite company, was bought for $5.1 billion by a group of private-equity firms including Apax, Permira and Apollo. This year's first big deal, a $5.7 billion offer by BC Partners and Cinven for Amadeus, a travel-reservations company, trumps any in 2004. Although private-equity firms are increasingly working together, there are clearly some benefits to scale.

The private-equity industry is usually seen as including two related businesses. One, buy-outs, involves acquiring established companies, often by taking them off the stockmarket. The other, venture capital, involves the funding of small firms, typically in technology or other fast-growing industries. In the past, small buy-out funds performed better than larger ones, but that has recently changed. According to Thomson Venture Economics, small buy-out funds (up to $250m) reported returns of 14.7% in the year to June 2004, compared with 26.3% for funds of greater than $1 billion.

Venture capital funds have been suffering, with a negative return of 12.2% on average in the past three years. Some are only now rebounding from the bust of 2001 and 2002. One firm, Apax, recently said that it would reduce its focus on venture capital and would pursue only later-stage deals. In future, seed funding for technology firms is likely to come from “angel investors”,

typically rich people looking for diversification, rather than institutions.

Investment bankers have seen an increasing share of their fees come from private-equity deals. These have accounted for 14% of the value of global mergers and acquisitions in 2004, up from 12.7% in 2003, reckons Dealogic. That is one reason why Goldman Sachs, or any other bank, might think twice before launching private-equity funds that compete against their clients. Another is that, for all their contacts, investment banks' private-equity units have not always been as sharp as the independent shops. To take but one example: J.P. Morgan's outfit bet big on technology during the bubble—and lost a bundle.

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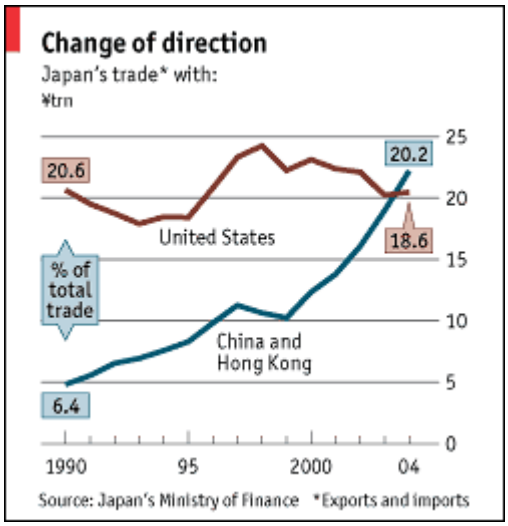
Japan's slowing economy

A-a-atchoo!

Jan 27th 2005 | TOKYO
From The Economist print edition

How serious are the latest signs of weakness?

Get article background



THE Japanese economy has long seemed allergic to growth. For more than a decade, every brief rebound has been followed by a negative reaction and a rash of pessimism. Now, with growth slowing again after a heartening three-year spurt, allergies may weaken the economy once more—this time, literally. This week the Dai-Ichi Life Research Institute estimated that exceptionally high pollen levels from cedar and cypress trees will knock 0.6% off this quarter's GDP. The think-tank estimates that reductions in spending on travel and other forms of leisure will more than offset increased sales of face masks, air cleaners, antihistamines and other remedies.

Will Japan soon be back on a path to recovery? Economists find few clear answers in the country's notoriously volatile statistics. The overall economy still seems healthier than it has been for a long time. Unemployment, at 4.5%, is at its lowest in five years; the ratio of job openings to applicants is at its highest since 1992. Bankruptcies keep falling, even as banks continue to clean up their balance sheets. Heizo Takenaka, the finance and economy minister, reckons that the country's biggest banks will reduce bad loans to 4% of their total portfolios by the end of March, half the ratio three years earlier.

Slowing output growth, however, will make it hard to translate any of this into more confident consumers or companies. *The Economist*'s most recent poll of forecasters predicted real GDP growth of only 1.6% this year. On January 25th, Japan's index of small-firm confidence fell for the fourth straight month, to its lowest in a year. A few months ago the Bank of Japan predicted that consumer prices would finally begin to rise mildly this year. But on January 24th Toshiro Muto, one of the central bank's deputy governors, said that consumer-price deflation may now continue until 2006.

Since exports and related investments have helped to fuel Japan's rebound, much hangs on the health of its trading partners, not least China. According to preliminary figures released on January 26th, China surpassed America as Japan's biggest trading partner in 2004, with bilateral trade (including Hong Kong), reaching ¥22.2 trillion ($214 billion). So if China's government succeeds in cooling demand, Japan's economy could suffer. Japan's worldwide exports fell by 5.6% in December, from the previous month, and were only 8.8% higher than a year earlier.

Despite all the wheezing, it is much too soon to conclude that yet another Japanese recovery has

ended prematurely. Indicators of potential investment contain hopeful signs as well as troubling ones. Robert Feldman, of Morgan Stanley, reckons that growth and profits will be looking better by the end of this year, and will perform strongly again in 2006. But those estimates depend on buoyant exports to America, China and Japan's other trading partners. There is still little indication that domestic demand is about to take up the running.

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Foreign listings in New York

Big Apple blues

Jan 27th 2005 | HONG KONG
From The Economist print edition

China's banks are the latest companies to shy away from a New York listing

IF YOU can make it there, as the song has it, you can make it anywhere. At least as far as New York's stock exchange is concerned, however, more and more non-American companies are deciding that they cannot—and some are no longer even willing to try.

European firms have been complaining for months about the rising costs and increasingly strict requirements of a listing on the New York Stock Exchange (NYSE), once considered essential for any self-respecting global corporation. Now two of China's big state banks, which are planning billion-dollar international flotations this year, may also be thinking again. At a time when big stock exchanges are vying for business from the mainland, London recently beat New York to win the overseas tranche of the initial public offering (IPO) of Air China, the country's flag carrier.

A big reason is the Sarbanes-Oxley act. Passed in the wake of the Enron and WorldCom scandals, this law calls for auditors to approve a company's procedures for preventing fraud and ensuring that its accounts are correct. It also requires managers to certify the effectiveness and adequacy of internal controls in year-end filings. For foreign companies registered with the Securities and Exchange Commission, America's main securities regulator, compliance with the internal-controls rule is due to start with the financial year ending on or after July 15th.

As well as the cost of all this in terms of time and money, foreign managers hate the thought of being sued in America if things go wrong. European bosses have been lobbying the SEC vocally, apparently with some success. On January 25th, William Donaldson, its chairman, said that he may give non-American firms more time to comply with the internal-controls clause. He may also change the SEC's rules to make delisting from American exchanges easier.

This might not satisfy Chinese firms, which have much further to go than Europeans in improving corporate governance. Marcia Ellis, of Paul Weiss, a law firm, says that although Hong Kong (the standard destination for Chinese listings) is in many ways a more demanding place to list than New York, “once you are on the New York exchange, life is much tougher. You are subject to class-action law suits and the SEC is a vigorous enforcer of the rules.”

China Life, the mainland's largest life insurer, has already discovered this. It is being investigated by the SEC and has a class-action suit pending, having failed to disclose old liabilities when it listed in America last year. The accounts of the banks are in far worse shape.

Just this week, Bank of China, which wants to raise $3 billion-4 billion in its IPO, admitted that two officials at a northern branch had absconded after embezzling 1 billion yuan ($120m), in the latest of several such scandals in the past few years. Although BOC, just like China Construction Bank (CCB), which is hoping for $5 billion-10 billion from its own flotation, is working hard to clean itself up, Standard & Poor's, a rating agency, noted that “the incident underlines weaknesses in the

bank's relatively new internal control procedures." It is no wonder that Liu Shiwei, assistant to BOC's head of restructuring, says that although the bank has not yet decided where its shares will be listed, "Sarbanes-Oxley will strongly influence our decision."

Fading attraction?

Nor, say Chinese bankers, is the prestige of an American listing what it once was. "The halo effect has gone," says an adviser to CCB, pointing to the fall from grace of Richard Grasso, the former head of the NYSE, and the fact that Enron and WorldCom were listed in New York. He adds that Chinese companies get higher trading volume and broader coverage by analysts in Hong Kong and Singapore, where listing is also cheaper. "There is really no reason for a Chinese company to list in New York unless it is a technology firm, where the ratings are higher."

Even so, New York has not lost all of its lustre. If BOC and CCB do shun the Big Board, they might still send a bad signal to potential investors, just when the banks are already struggling to persuade foreign banks to take minority stakes. So a refusal to take on New York could bode poorly for their IPOs. Nobody said making it there was easy.

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Economics focus

India's poor law

Jan 27th 2005
From The Economist print edition

The Indian government wants to guarantee employment for the rural poor. Can it afford to do so?

Get article background

AS THE devastating Indian famine of 1877-79 drew to a close, India's British rulers worried that their relief efforts might have gone too far. If the poor were entitled to relief in times of distress, the Famine Commission argued, they might soon demand relief at all times. India might get its own poor law—a prospect the niggardly Victorians could not "contemplate without serious apprehension".

India's coalition government, the United Progressive Alliance (UPA), finds itself in the predicament the British Raj was so anxious to avoid. For decades, the Indian state has laid on public works in response to drought or flood, giving destitute farmers and labourers the means to buy food. One such drought in 1972-73 prompted the state of Maharashtra to go a step further: it issued a standing guarantee of employment, at the legal minimum wage, to anyone who wanted work. Now the UPA, which owed its surprise election victory last May in part to rural discontent, has promised to extend a similar guarantee to the nation.

To its advocates, a rural employment guarantee represents an historic opportunity to weave India's first reliable social safety net. Others, with an eye on the government's disquieting budget deficit, share the Victorians' serious apprehension.

The appeal of poor-law relief, according to John Stuart Mill, was that it is "available to everybody [but] it leaves to every one a strong motive to do without it if he can". The state does not test a person's means, but by offering low wages in return for hard work it deters those who can support themselves. In theory, wages should be close to, but slightly below, the market wage. They should, as Mill said, "give the greatest amount of needful help, with the smallest encouragement to undue reliance on it."

At its peak in the fiscal year 1985-86, Maharashtra's employment guarantee provided 189.5m man-days of work. Labourers turned to the scheme during lean times, then left during busy harvest periods. Some of the wages paid ended up in the pockets of corrupt local officials. But most studies suggest the guarantee targeted the poor rather better than India's other welfare schemes. India's food subsidies, for example, are often misdirected. One study found that over 30% of those who received a ration of subsidised rice and wheat were not poor, and about half of the poor received no ration at all.

If work requirements serve simply as a screening device, separating the indigent from the indolent, it does not much matter what labourers are paid to do. In Maharashtra, they have reportedly built rural roads that are washed away by the next monsoon. But the poor's labour

does not have to be Sisyphean. Thanks to public works, mango groves, orange orchards and other forms of horticulture now cover almost 1m hectares of Maharashtra's soil, compared with just 173,000 hectares in 1990.

That said, the real value of the public works lies not in the orchards they plant, but in the safety net they provide. The rural poor, with little access to credit or insurance, have few opportunities to smooth their consumption in the face of misfortune. As a result, they tend to be conservative in their farming decisions, eschewing productive ventures that might raise the expected value of their income, but also raise its variance. Despite the clear risk of corruption by the officials administering it, an employment guarantee could give the poor something to fall back on. This might encourage farmers to take productive risks, such as experimenting with high-yielding seed varieties. It might spare them from distress sales of draught animals, keep them from pulling their children out of school and stop them from migrating to city slums.

But is a credible guarantee affordable? The UPA inherited a consolidated budget deficit of around 10% of GDP. Its public debt amounts to over 80%, though most of it is held at home, in rupees and at long maturities. An employment guarantee would increase this fiscal burden, but by how much?

A lot depends on the wages offered. The Maharashtra scheme pays the statutory minimum wage. Prior to 1988, according to a 1993 study by Martin Ravallion, Gaurav Datt and Shubham Chaudhuri of the World Bank, this state minimum was roughly in line with prevailing agricultural wages. In 1988, however, the minimum wage was doubled overnight. Many feared the fiscal consequences. Offering above-market wages is triply expensive. It attracts more workers, pays each of them more and displaces them from private employment.

Surprisingly, the fiscal burden actually fell after 1988—mainly because jobs were tacitly rationed. The World Bank authors showed that the scheme met only 43% of the demand for work that year. Newspapers reported slums “mushrooming” on the edge of towns. After 1988, Maharashtra's famous employment guarantee no longer guaranteed employment.

A three-pronged fork

Employment guarantees pose a policy “trilemma”. In principle, the Indian government might like to achieve three goals: an unconditional guarantee of employment, at the minimum wage, without busting the budget. In practice, it can achieve any two of those three. If it offers above-market wages, it can contain the fiscal cost only by diluting the guarantee.

The UPA originally promised to pay minimum wages, which are set by each state. It has now backed away from this commitment, reserving the right to set wages centrally. But the UPA has also diluted the guarantee. It offers only 100 days of work for one person per household. And, according to a strict reading of the draft law, the guarantee may only be enforceable for households officially classified as poor. India's poor law may thus come to rely on a means test, contrary to the spirit of Mill. With the budget deficit looming, the government's poverty-fighting ambitions may be giving way to its fiscal apprehensions.

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Global health

Foundation

Jan 27th 2005
From The Economist print edition

AP

The world's richest charity confronts the health of the world's poorest people

THREE-QUARTERS of a billion dollars is a lot of almost anybody's money. Almost anybody, that is, except Bill Gates. Even for him, though, it is more than small change. And that is the size of the donation announced on January 24th by the foundation that bears his name and that of Melinda, his wife. The money is going to the Global Alliance for Vaccines and Immunisation (GAVI).

The Gates foundation is the richest charity in the world. Its endowment is worth $28 billion. Its annual income is that of a small country. And its founders are on a mission. The more modest parts of that mission are to improve America's schools and libraries and to benefit Mr Gates's native region of the Pacific Northwest (charity, after all, begins at home). The most ambitious part, though, is to free the world—and, in particular, those regions of it that are poor—of ill health.

The donation to GAVI is merely the latest of a series of gifts intended to combat disease in the tropics. The foundation's contributions have almost doubled global spending on research into malaria. They have formed the largest non-governmental gifts to the Global Fund to Fight AIDS, Tuberculosis and Malaria, which was set up at the prompting of Kofi Annan, the United Nations secretary-general, to combat those diseases. Independently of this, they have helped entire countries to set up anti-AIDS programmes. They have driven the creation of the Global HIV/AIDS Vaccine Enterprise, which, earlier this month, published a plan designed to pave the way to such a vaccine. And in a few months' time they will begin to fuel the most ambitious project of all, an attempt to bulldoze 14 “roadblocks” which the foundation has identified as standing in the way of its medical objectives, and which it has dubbed its “Grand Challenges in Global Health” initiative.

This scale of spending could indeed transform tropical-disease research and treatment, as the

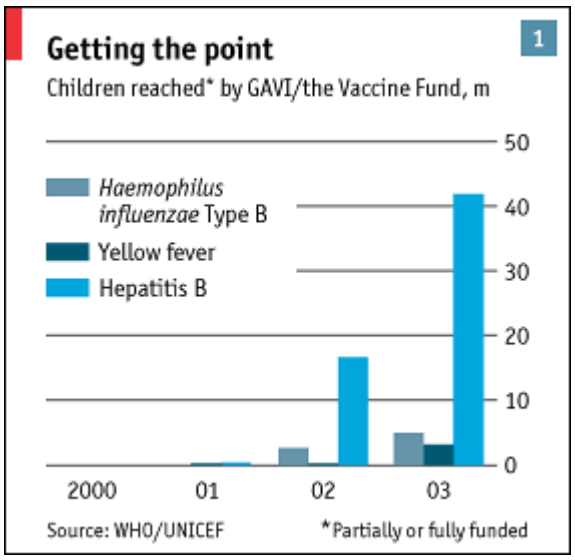
Grand Challenges project intends. That is certainly the foundation's aim—and it is a laudable one. But two risks come with it. One is that he who pays the piper calls the tune. With such a large amount of money at their disposal, the foundation's scientists might end up, albeit unwittingly, controlling the research agenda in these areas.

The second risk is that other foundations—and governments, even—might feel that so much Gates money is flowing into global health that they can cut back on their own contributions. Then, ironically and unintentionally, the Gates foundation might end up with the sort of quasi-monopoly in its field that Microsoft, the source of Mr Gates's wealth, enjoys in its.

Foundation and empire

With luck, neither of those things will come to pass. Patty Stonesifer, the foundation's president, and Rick Klausner and Helene Gayle, its top scientists, are certainly aware of both risks. The first, of unintentionally calling the tune, is dealt with by what might be described as an auction of ideas. Though some money is simply given to good causes that approach the foundation, much of it, particularly that directed towards research, is awarded by open competition—as, for example, in the case of the Grand Challenges. The challenges themselves were the distilled wisdom of 1,000 ideas from the world's scientists. Once they were announced, 1,500 suggestions for meeting them flooded in, and these have been refined into 400 formal proposals which are now being sifted through by a panel of independent scientists. As Dr Klausner puts it, “the idea is to stimulate the agenda, not create it.”

The risk of displacement is dealt with by an explicit understanding that the foundation will have no permanent pensioners. As its website rather inelegantly puts the matter, “Priority is given to projects that leverage additional support”. In this regard, GAVI is a good example. The alliance (of disparate interested parties ranging from UN agencies to industry representatives), and its financing arm, the Vaccine Fund, were in essence created by the Gates foundation with an initial grant, also of $750m, in 1999. This was intended to last five years, and those years are now up—hence the new announcement. But the second $750m tranche is designed to last ten years, rather than five.



GAVI is being weaned. In its first five years its Gates money amounted to about half of its income, despite the fact that 11 national governments also chipped in. That got the alliance on its feet (see

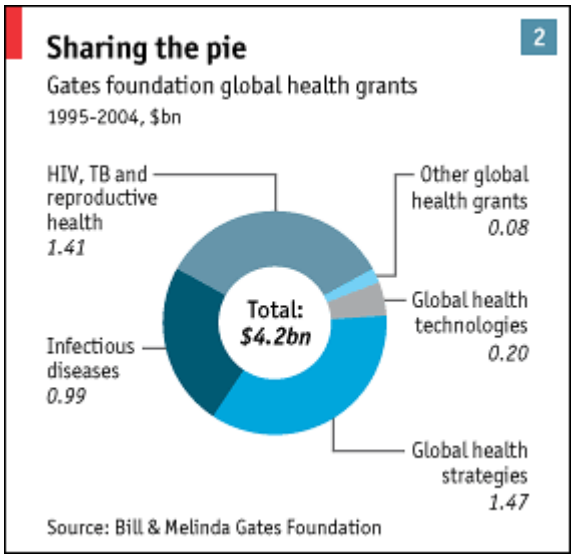
chart 1). But if it is to fulfil its objective of giving comprehensive vaccine protection to 90% of newly born children in the countries it serves by the end of those ten years, then it will need a lot more cash: some $8 billion-12 billion by its own estimates. That is way more than the Gates foundation wants to give, or, indeed, can afford. But the weaning strategy seems to be working. On January 24th Norway chipped in $290m, and on the 26th Britain followed suit with $1.8 billion, to be channelled to GAVI through a newly created International Finance Facility for Immunisation.

However, while it is true that the foundation's strategy is not to monopolise the field, monopsonies—that is, dominant purchasers—are a different economic animal from a donor's point of view. Creating a monopsony was certainly part of the motive behind GAVI. Childhood vaccination is a cost-effective way of saving lives, and one of the foundation's precepts is, as it were, to buy lives cheaply: that way more people can be saved. But GAVI represents a way to do it more cheaply still. By creating a purchase fund that bundles together the requirements of the countries it serves (some 70 nations that have a GDP per head of less than $1,000), GAVI creates a large, reliable demand that stimulates more companies to get involved in manufacturing existing vaccines, provides an incentive to develop new ones, and pushes down unit prices.

Another way of buying lives cheaply is to make sure the money is neither wasted nor stolen. For this purpose GAVI, at the foundation's instigation, has strict auditing procedures. So far, 41 countries have been audited. Of these, 25 passed and 16 failed. If a country's vaccination programme is successful, it is rewarded. If a programme is seen to be failing, GAVI will work with that country to identify the problem and try to correct it. But if correction is impossible, funds will be cut off—as has already happened in six cases.

The principle of unity in diversity has also informed the foundation's involvement in the Global HIV/AIDS Vaccine Enterprise. The purpose of that enterprise is to promote collaboration between funding bodies, such as the Gates foundation itself and the International AIDS Vaccine Initiative, and scientists, both academic and commercial. Such collaboration cannot, of course, be unconditional. Commercial scientists work for organisations that need to protect their intellectual property in order to make a profit. But by establishing agreed standards for testing putative vaccines, encouraging the maximum possible sharing of data, and planning how a vaccine might be manufactured in bulk and deployed, even before it is ready, the enterprise intends to speed the shining hour. The hope is that this sort of “industrialisation” of the discovery process will become a model for future research. Indeed, the foundation has already detected interest in a similar enterprise to discover and deploy a malaria vaccine.

The Global HIV/AIDS Vaccine Enterprise is a more speculative investment than the one in GAVI, since no one knows for sure that an AIDS vaccine can be developed. Nevertheless, AIDS is such a threat to world health, and also one of the biggest obstacles to economic development, that in this case speculation could bring a huge dividend.



In fact, combating AIDS both directly and by indirect methods such as improving reproductive health, particularly for women, and attacking the tuberculosis that kills so many HIV-infected people, already absorbs a third of the foundation's spending on health care (see chart 2). Besides contributing to the Global Fund, the foundation is intimately involved in two large projects. Again, the targets have been carefully chosen. ACHAP, the African Comprehensive HIV/AIDS Partnerships, is Botswana's anti-AIDS project. Botswana vies with Swaziland for the unenviable title of country with the highest HIV infection rate. According to UNAIDS, the UN agency responsible for combating the disease, almost 40% of Botswana's adult population has the virus. Unlike Swaziland, however, it is a well-governed democracy. Yet, with a population of 1.8m, it is small enough for the foundation to make a real difference.

Another country in which the foundation is taking a direct interest is India. Here, its Avahan programme, backed by $200m of foundation money, has concentrated on the country's lorry drivers, a trade whose members had a large share of responsibility for spreading HIV in Africa. It has co-opted India's main oil company and also its national truckers association to spread the message to drivers that they should take care not to spread the disease. It has also tackled the difficult task of making AIDS a topic of polite conversation by recruiting Raul Dravid, a prominent cricketer, to the cause. India is in Dr Gayle's sights not so much because of how bad things are there, but because of how bad they could become. Even though the adult infection rate is less than 1%, that still amounts to some 5m people, making India the second-most infected country, in terms of total numbers, after South Africa. The idea is to nip the epidemic in the bud.

Second foundation

The Grand Challenges initiative, though, may dwarf all this. Its scope is so ambitious that it is almost a foundation within a foundation (the actual administration is being done by America's Foundation for the National Institutes of Health). The challenges in question (Dr Klausner borrowed the title from a lecture delivered in 1900 by a mathematician called David Hilbert, which outlined 23 grand challenges in maths for his successors to solve) range from the mundane (“prepare vaccines that do not require refrigeration”) to the esoteric (“develop a genetic strategy to deplete or incapacitate a disease-transmitting insect population”). The latter will require both serious genetic engineering and a public relations campaign designed to persuade people that it is safe and sensible to unleash engineered insects into the wild.

Nor are basic matters neglected. As David Fleming, the foundation's Global Health Strategies

director, points out, half of childhood deaths in the poor world have malnutrition as an underlying cause. So one of the challenges is “to create a full range of optimal, bioavailable nutrients in a single staple plant species”. More genetic engineering there, in all probability, or maybe a revolution in plant breeding techniques. So, if a new, healthy crop called *Billgatesia* graces your table one day, you will know who to thank.

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COX-2 inhibitors

Vioxx nation

Jan 27th 2005
From The Economist print edition

The risks and benefits of new anti-inflammatory drugs

FOR drugs that are meant to relieve pain, COX-2 inhibitors—a new class of medicines to treat arthritis and other inflammatory diseases—are causing plenty of discomfort these days. Merck, an American drug company, withdrew Vioxx, its $3 billion-a-year blockbuster, from the market in September after clinical trials revealed it doubled the risk of heart disease. The safety of several other COX-2 inhibitors, among them Celebrex and Bextra made by Pfizer, the world's largest drug company, has also been questioned. Next month America's Food and Drug Administration (FDA) will hold a public hearing to look at the risk and benefits of these drugs.

Even the FDA is suffering serious side-effects from the controversy over COX-2 inhibitors. Last November, David Graham, one of its officials, testified before a Senate hearing on the risks of Vioxx. He alleged that the FDA had tried to suppress his research and should have acted years earlier when signs of the drug's risks first appeared. By being more interested in getting new drugs to market than scrutinising their safety, Dr Graham believed “the FDA has let the American people down, and sadly, betrayed a public trust.”

In this week's *Lancet*, Dr Graham has published the research that prompted his congressional comments. He and his colleagues from Vanderbilt University and Kaiser Permanente, an American managed-care company, have studied the records of 1.4m of Kaiser's members who were prescribed several different anti-inflammatory drugs between 1999 and 2001. More than 8,000 of them developed serious heart disease, leading to more than 1,500 deaths over this period.

Misfortune, however, was not evenly distributed. After accounting for age and sex, those taking Vioxx had a significantly higher chance of developing heart disease than those on Celebrex. Even naproxen, an older anti-inflammatory drug once said to protect the heart, was associated with a slightly elevated risk of heart disease. And contrary to Merck's recent study suggesting that such problems with Vioxx start to appear after a year and a half of treatment, Dr Graham's team found an elevated risk within four months of starting the drug. Extrapolating these findings to the American population at large, Dr Graham chillingly estimates that 88,000-140,000 extra cases of serious heart disease may have resulted from people taking Vioxx between 1999 and its withdrawal.

For all their bad press, the COX-2 inhibitors can help patients who suffer gastro-intestinal bleeding and other nasty complications from older anti-inflammatory drugs, because of the way these newer drugs act on particular inflammation pathways in the body. Indeed, a smaller study by Fadia Shaya and her colleagues at the University of Maryland, published in the current issue of *Archives of Internal Medicine*, shows no rise in the risk of heart disease among those taking COX-2 inhibitors compared with those taking the old drugs in their target population, mainly young, poor black women. As Dr Shaya points out, it is important to look at the relative risk—and what works in one population may not work in another.

The trouble with the COX-2 inhibitors is that they have been prescribed to a far wider population than may have strictly needed them. Caleb Alexander and his colleagues from the University of Chicago and Stanford University have looked at national survey data to understand when American doctors prescribe these drugs. Their findings, also published in *Archives of Internal Medicine*, show that much of the rapid rise of these drugs has been among those who could have taken older—and cheaper—anti-inflammatory drugs instead.

Between 1999 and 2002, they estimate that prescriptions of COX-2 inhibitors to those at lowest risk of gastro-intestinal complications (and thus in least need of the new drugs) roughly trebled. Ironically, all the direct-to-consumer advertising that aimed to bring these drugs to the masses may result in them being taken out of reach permanently.

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Climate change

Hot models

Jan 27th 2005
From The Economist print edition

How to model the climate on the cheap

AP

Storms ahead

Get article background

THIS month saw the start of a period when climate change will be in the news a lot. On January 17th Chris Landsea, a hurricanes specialist, withdrew from the Intergovernmental Panel on Climate Change, accusing it of “having become politicised”. On January 25th a report by the International Climate Change Taskforce called for drastic actions to cut carbon dioxide (CO_2) emissions. On February 1st a conference on the subject will be held at Britain's Hadley climate centre. And on February 16th the Kyoto protocol comes into force. You have been warned.

As part of the fun, there was also the publication of an intriguing paper in *Nature*. The research was intriguing not so much for what it said (things may get hotter than expected), but for how it arrived at that conclusion. For it was one of the first serious scientific studies to exploit the idea of distributed computing.

Modelling the climate requires a huge amount of computing power, which is one reason the models have not been tested as thoroughly as they might have been. So David Stainforth of Oxford University and his colleagues decided to employ the idle capacity of 95,000 private desk-top computers to do it for very little money. Willing computer owners registered at a website (climateprediction.net), downloaded the appropriate software and then used their machines as normal. This enabled Dr Stainforth to test what is known as the Met Office Unified Model with 2,000 different sets of starting parameters.

Dr Stainforth wanted to explore the consequences of doubling CO_2 levels from their pre-industrial values (at the moment they are about 1.6 times what they were at the beginning of the industrial revolution). What he observed, depending on the values of the parameters (such things as average cloud cover) was a range of increases between 2°C and 11°C, which is far greater than the current consensus of 2-3°C.

That is not as alarming as it sounds since, by his own admission, the model Dr Stainforth has been testing is crude. It dumps all its CO_2 into the atmosphere in one go, instead of leaking it in over the years. And its description of the interaction between atmosphere and ocean is far too simple. But it does point the way towards a better way of doing the modelling business. And a cheaper one, too.

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The Richard Casement internship

Jan 27th 2005
From The Economist print edition

We invite applications for the 2005 Richard Casement internship. This is for a would-be journalist under 25 to spend three months of the summer on the newspaper, writing about science and technology. Our aim is more to discover writing talent in a science student than scientific aptitude in a budding journalist. Applicants should write a letter introducing themselves, along with an original article of about 600 words which they think would be suitable for publication in the Science and technology section. They should be prepared to come for an interview in London or New York, at their own expense. Applications must reach us by February 21st. They should be sent by e-mail to casement@economist.com

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Correction: Sir Harry Kroto

Jan 27th 2005
From The Economist print edition

On January 15th (see article) we said that Sir Harry Kroto, the discoverer of Buckminsterfullerene, was at the University of Florida. In fact, he is at Florida State University. Sorry. This error has been corrected online.

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Robert Louis Stevenson

Slinger of ink

Jan 27th 2005
From The Economist print edition

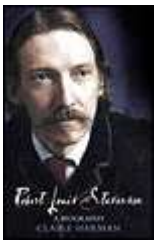
Bridgeman

A man who, by turns, was seductive and infuriating

IN 1885 Robert Louis Stevenson dreamed a “fine boguey tale” that in a matter of weeks had been turned into one of the most famous stories ever published—indeed, so famous, Claire Harman says, that it hardly needs to be read at all. At its heart is not just a shocking story of evil and transformation, but also a crystallisation of man's greatest dilemma, his relationship with himself. “The Strange Case of Dr Jekyll and Mr Hyde” exposes, as Dr Jekyll himself says, “the thorough and primitive duality of man”. The strength of Ms Harman's new biography is how it engagingly explores in fresh detail how the conscious warred with the unconscious in Stevenson himself.

Born into a long line of obsessive and successful engineers, Stevenson quickly revolted against such a calling and was determined to be a “slinger of ink”. He spent the first half of his life as a near-invalid, ill and frail and certain he was doomed to an early death, just like Shelley. And, like Shelley, he was “toiling to leave a memory behind”. In the second half of his life—as close friends submitted to one fatal illness after another—

Robert Louis Stevenson: A Biography
By Claire Harman



HarperCollins; 503 pages; £25

Buy it at
Amazon.co.uk

Stevenson conceived an unlikely lust for life while touring the South Pacific, submitting to the roughest and most dangerous of conditions, but this time with barely a murmur.

Ms Harman's is the first biography of Stevenson since an eight-volume edition of his collected letters was published by Yale University Press in 1994-96. She uses the wealth of new evidence to examine her subject's extraordinary range of interests, a mercurial side that sometimes verged on unpleasantness, and his ever urgent desire to earn money.

For years, Stevenson allowed himself to be pampered, fussed over and financed by overbearing parents and by “Cummy”, his sainted nanny—while taking every opportunity to escape their influence. He sat in dark rooms with writer's block, depressed and self-pitying. Yet at the Savile Club he was recognised by Henry James and others as a wit, a wag and a bohemian. He took countless trips to spas in search of a cure for his undiagnosed and occasionally hypochondriacal illness. Yet he told J.M. Barrie that he smoked cigarettes “without intermission except when coughing or kissing”. Even after his first alarming experience of spitting blood, he still saw himself as a professional consumptive in search of a cure, blind to his own self-abuse.

When ill himself (tuberculosis was never formally diagnosed), Stevenson showed great compassion to other sufferers, as his friendship with William Henley, a long-hospitalised poet, testifies. Ms Harman has found an unpublished poem by Henley which neatly encapsulates his friend's personality:

> An Ariel quick through all his veins
> With sex and temperament and style;
> All eloquence and balls and brains;
> Heroic and also infantile.

Stevenson was a fanatical launcher of projects which he rarely finished. In his essays, he laboured over style and ideas, inventing many aphorisms that were quickly adopted by books of quotations (“To travel hopefully is a better thing than to arrive”). Yet his most popular, and profitable, works were impulsively tossed off: “Treasure Island” began as a map he painted for his stepson one rainy day, followed within days by chapters serialised in a children's paper, *Young Folk*. It then lay in a drawer for two years before anyone thought it worth putting out as a book.

For Cummy—who had the most baneful influence on him as a boy, condemning theatre as the mouth of hell, prescribing caffeine for insomnia and instilling a very literal fear of damnation—Stevenson wrote the bucolic “A Child's Garden of Verses”. This is one of his most enduring works, written in a dark, shuttered room when his health was at its worst.

Stevenson's contradictions come to the fore in his relationships with women. Mothered and smothered when young, he later became obsessed with women who seemed to want most to control him. His early manhood was dominated by a largely unrequited love for the married Frances Sitwell, but he eventually transferred his obsession to an American, Fanny Osbourne, another married woman, whom he met in France during one of his bohemian escapades.

In praise of wives

He travelled to and across America to persuade Fanny to leave her husband; when she relented at last, Stevenson found himself married to someone who matched him for hysteria and hypersensitivity. Fanny became his harshest critic, but also his inspiration and a trusted editor. Literary friends of Stevenson's saw her as a gold-digging bore. Yet Stevenson never had a sharp word in public to say against his wife and described himself as “uxorious Billy”. Their relationship only ever showed real signs of strain when his own condition seemed to stabilise and his future

look brighter.

As a biographer, Ms Harman feels that subjects become “less knowable the more data accrues around them”, but that through this mess of information there is a glimpse of “real life poking through”. And so it is, for better or worse, that she rarely takes a firm position about her subject. Her complex portrait paints a man whom she finds both admirable and infuriating. Her prose has such narrative force that Stevenson's death from cerebral haemorrhage leaves a genuine sense of shock and loss. Ms Harman's kaleidoscopic light suits a man whose personality seemed in a state of constant flux.

Robert Louis Stevenson: A Biography.
By Claire Harman.
HarperCollins; 503 pages; £25

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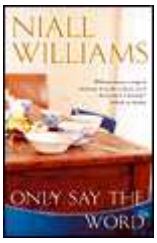
New fiction

A healing force

Jan 27th 2005
From The Economist print edition

THIS is Niall Williams's fourth novel, a mesmerising one that explores the redemptive quality of words. Taking its title from a prayer said before the Roman Catholic communion—"Lord, I am not worthy to receive you, but only say the word, and I shall be healed"—this book has two parallel narratives.

Only Say the Word
By Niall Williams



Picador; 260 pages; £12.99

Buy it at
Amazon.co.uk

It starts with the words of a writer, Jim Foley, who, in a cottage on the soft and airy west coast of Ireland, is drafting a long love letter to his dead wife, Kate. Through this letter, we learn of the despair of Jim and his children at Kate's death, and of the subsequent meaninglessness of their lives. "Some cog in the works of living has fallen out, and though the wheel of our days still turns, it does so with a buckled warp, all the time losing ground."

The narrative of this letter is interwoven with the story of Jim's own life. He describes a melancholy childhood in County Clare, a father who "seemed without friends", the death of a baby sister, and a mother "unable to escape the prison of loneliness in which she found herself." He leaves the family for Trinity College, Dublin and then America, where he meets and marries Kate before their return to Ireland.

Mr Williams has a strong prose style and a keen sensitivity to the soul-numbing tentacles of grief and the pain of lost love. Jim's enduring love of books, and his reliance on the written word as a curative force, is a constant theme. Stolen books provide the escape he desires from his childhood, while the letter to his wife takes him from the unbearable present.

What anchors the book are the warm descriptions of places and events. Entering a pub, Mr Williams writes, is "like moving inside some uncle's comfortable old coat where the smells of beer and smoke and living swirl around you at once and hold you closely." University lecturers "progress like wallpapers, covering everything with a grey paste of critical analysis."

"Only Say the Word" is a book about acceptance of the past and about an attempt to move towards a fragile, redemptive peace. It is heart-rending and unforgettable.

Only Say the Word.
By Niall Williams.
Picador; 260 pages; £12.99

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Leigh Hunt

English radical

Jan 27th 2005
From The Economist print edition

HIS name is thickly scattered through the biographies of others, chiefly Shelley, Byron, Keats, Lamb and Hazlitt. But as a man in his own right—admired, sought after and attacked in his day—Leigh Hunt has had little more than scholarly attention. After a long wait, two biographies have now come along together.

No doubt Hunt himself would have penned a cheerful sonnet on the vagaries of time and fame, and he would have done so in 15 minutes flat, a game against the clock that he was fond of playing with both Keats and Shelley. He enjoyed writing like this—not in sublime Romantic solitude, but companionably, round the fireside. Well before Dickens popularised it, the "fireside" was a potent idea with Hunt, who maintained a heroic geniality in the face of bleak circumstances: sickness, debt, too many children and an increasingly alcoholic wife.

Hunt was a poet, essayist and theatre critic. Above all, he was the editor of the *Examiner,* the most outspoken radical journal of its time, founded with his brother John in 1808. It was the period of George III, Shelley's "old, mad, blind, despised" king, and of political repression in the wake of the French Revolution and the threat of invasion by Napoleon. In this climate of fear, the *Examiner* often sounds modern in its defence of civil rights and liberties (habeas corpus and parliamentary reform), its campaign for religious toleration (Catholic emancipation) and its exposure of inhumanity (the slave trade, military floggings). Neither Hunt brother would budge on the principle of free speech, and both were tried and imprisoned for it.

For Hunt, literature was always part of politics. His school, Christ's Hospital, had banned books in English about the classics, which were privileged territory, not for the masses. In the same way, the critical establishment had tried to fence off poetry. An expression such as "pin-drop silence" (Hunt's own) was scoffed at as a "milliner's phrase"—and, by implication, almost Jacobin. Hunt was the first to publish the "Cockney" Keats, to give space to the "seditious" Shelley and to defend the notorious Byron. In his own writings, especially his essays, his style was quirky, democratic and off the cuff in a way that foreshadowed Dickens or Browning. He wrote as if he were walking with the reader, arm in arm.

No dogma underpinned this, neither atheism, nor republicanism, nor any theory of aesthetics. What animated Hunt was an almost naively simple belief in everyone's personal desire to be happy. Snobbery, injustice and corruption were hateful because they struck at just that level, at

Fiery Heart: The First Life of Leigh Hunt
By Nicholas Roe

Pimlico; 428 pages; £14.99

Buy it at
Amazon.co.uk

The Wit in the Dungeon: The Life of Leigh Hunt
By Anthony Holden

Little, Brown; 430 pages; £20 and $20

Buy it at
Amazon.com
Amazon.co.uk

“the ties of domestic life, the daily routine of society”.

Nicholas Roe's biography deftly pulls together the political, poetic and personal threads. He is a close reader, alive to words and allusions, and steeped in the history and ideas of the period. He makes the reader see it all, too: the streets of London, the prostitutes, the theatres, the bookstalls and Hunt's beloved Hampstead. He gives you the weather, reads the newspapers for you and takes you to riots and to hangings where a groan goes up as the executed heads are displayed. This is biography at its best.

Mr Roe ends his story in 1822, when the death of Shelley, by then Hunt's dearest friend, closed the most productive part of his life. Hunt lived on until 1859, though many thought that he had indeed gone out with the Regency. Anthony Holden's biography follows him to the end, clearly and intelligently, though without the restless engagement and historical richness of Mr Roe. Still, Hunt's journey through successive generations of new friends has its own pathos, since his chronic failure ever to get to grips with money tainted the very thing he stood for, namely, good fellowship. Mr Holden's pages on Thomas Carlyle's admiration, friendship and eventual exasperation are especially telling, as is his dissection of Dickens, who clouded Hunt's last years with a cruel caricature of him as Harold Skimpole in “Bleak House”.

Fiery Heart: The First Life of Leigh Hunt.
By Nicholas Roe.
Pimlico; 428 pages; £14.99

The Wit in the Dungeon: The Life of Leigh Hunt.
By Anthony Holden.
Little, Brown; 430 pages; £20 and $20

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Anthony Caro

Primary form

Jan 27th 2005
From The Economist print edition

A sculptor who abandoned the representation of things has come back to it

AT THE turn of the 1960s, something happened to sculpture. It came down off its pedestal. It looked to new materials such as steel in the pursuit of new forms and new ideas. One man at the heart of that revolution was a British sculptor, Sir Anthony Caro, whose life's work is being surveyed at Tate Britain, London, from this week. The exhibition runs until April 17th.

“When I was young, sculpture was a secondary art form, something which, at best, embellished buildings,” this extraordinarily spry 80-year-old says. “It had been like that, with a handful of honourable exceptions, for several hundred years. Unlike painting, it just wasn't taken seriously. Now, amazingly, all that has changed.” Sculpture has re-established its proper place in the plastic arts.

Just how much Sir Anthony's own work has changed can be seen from this show. Physically, the exhibition starts in the Duveen galleries, which were purpose-built in 1937 precisely to display the kind of giant, monumental work which is on show there today. Temporally, it begins with the present day: a new work called “Millbank Steps” loosely echoes the form and the structure of the steps which you ascend to the gallery's old entrance on Millbank, by the Thames.

It is characteristic Caro—giant plates of rusting steel, bolted and welded together into four sets of tall, step-like forms, back to back, which gives them the appearance of ziggurats. All four are linked together by fans of steel plate at floor level. No carving, no modelling: this is the continuity of a sculptural style that began almost half a century ago.

The visitor then turns out of the Duveen galleries and into a series of spaces which tell the story of Sir Anthony's work in chronological order, beginning with the 1950s, an era during which he was a studio assistant to Henry Moore. (One of the drawings on the wall has corrections in Moore's own

hand.) Here is the kind of figurative work which Sir Anthony was later to abandon so dramatically. One piece, cast in bronze, shows the head of a man smoking a cigarette. Somehow, it already feels as if that casual posture is being undersold when cast in such a traditional material as bronze.

Then, in the second gallery, a new world of possibilities seems to be opening up, with some of Sir Anthony's earliest abstract sculptures from the 1960s, open-work forms in painted steel and aluminium, all resting on the ground. Not a plinth is in sight. The pieces look freshly painted for this new gallery outing, tricked out in brilliant reds, magentas, greens and oranges. They still have the vitality about them of a new idea in modernity.

As you move through the exhibition, experiments become apparent with new materials, new combinations of materials and new patinations. There is ceramic in combination with steel, steel in combination with aluminium or bronze, and paper. In the later 1960s Sir Anthony began to make what he called “table sculptures”, small-scale abstract works which gain at least a part of their friskiness and energy from being poised dangerously on the very edge of the table.

The show ends in the second of the long Duveen galleries, with a multi-part work in wood and ceramic called “The Last Judgement” (1996-99), first shown at the Venice Biennale. In this work you see Sir Anthony inching back towards the representation of things once more. A series of wooden tabernacles contain crudely fashioned ritual objects, skull-like forms, blockish feet. How did he see this change in his work? The earlier sculptures, he says, were more like adverbs than nouns. He wants to bring thinginess back into sculpture. After all, says Sir Anthony, it's a more romantic age.

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The real Japan

True history of the Carey gang

Jan 27th 2005
From The Economist print edition

CHARLEY, the author's 12-year-old son, is growing up in Manhattan, and is into the usual adolescent things like skateboarding and PlayStation 2. But what really makes the shy boy bloom is the world of *manga*, Japanese comic books with startling graphics, along with *anime*, their counterpart in animated film. Sensing a chance at once to learn more about his son and "what all the really weird stuff means", Peter Carey takes Charley to Tokyo to meet the artists and film directors behind such works as "Mobile Suit Gundam" and "Blood: the Last Vampire". Charley makes his father promise: "No temples, no museums."

Wrong About Japan: A Father's Journey With His Son
By Peter Carey

Knopf; 176 pages; $17.95.
Faber and Faber; £12.99

Buy it at
Amazon.com
Amazon.co.uk

This slim volume, about their adventures, is not the first to punctuate Mr Carey's string of stunning novels, and it is a pleasure to read. *Manga* and *anime* are a national passion—and big business—in Japan. Mr Carey restlessly tries to elicit from those he meets a clue to the elusive nature of Japaneseness. The giant robots, piloted by space cadets inside them: are they a symbol of the second world war, or an image of alienation, or do they correspond to Japan's army of "socially inept information junkies"? No, he is told, they are a marketing device to sell toy robots. Forced to rely on interpreters to conduct his interviews, Mr Carey turns the imagery on himself: "locked inside my skin, lost in space, emotionally disconnected from my fellow humans."

Charley has a more enjoyable time, perhaps, despite his father dragging him, unpardonably, to a four-hour *kabuki* performance. Through the internet, he has a friend. Takashi dresses as a galactic warrior and acts as a spirit guide through Tokyo's techno-labyrinth of *stuffu*.

Father and son embarrass each other and bicker affectionately. The otherness of Japan, real and imagined, parallels the distance of adolescence. It is often hard not to be wrong about both. Still, Mr Carey is right about many things, including "the fastidious attention to detail, the perfectionism which seems so distinctively Japanese". What is more, as an elegant transvestite in a yellow dress, author of a vast encyclopedia of robot *manga*, illustrates, misunderstanding is not a one-way street. "Europeans are brought up thinking that if they take their clothes off they'll all turn into werewolves," she tells Mr Carey. "Do you understand?"

Wrong About Japan: A Father's Journey With His Son.
By Peter Carey.
Knopf; 176 pages; $17.95.
Faber and Faber; £12.99

The Economist's Christmas competition

Wisest fools

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From The Economist print edition

The winning entries

READERS of our Christmas issue were invited to nominate the wisest fool of the past 50 years. They responded magnificently, albeit often predictably: George Bush junior was much the commonest choice. But this was not a popularity contest, or an unpopularity one, and Mr Bush, though both wise and foolish in different measures, fits the bill less exactly than some other candidates.

Except Jack Kennedy, every eligible president of the United States was nominated, along with every recent president of Russia (or the Soviet Union), Mao Zedong, Jawaharlal Nehru, Charles de Gaulle, Tony Blair, Robert McNamara, Henry Kissinger, Norodom Sihanouk, Ralph Nader, Silvio Berlusconi and many other politicians. Alan Greenspan was a popular choice, but surprisingly few businessmen were proposed; Donald Trump, Kenneth Lay, Steve Jobs, Sir Richard Branson and Lord (Conrad) Black were those most often mentioned. Even fewer women were nominated, though Diana, Princess of Wales, was a strong contender.

Readers suggested several musicians, such as John Lennon, Paul McCartney and Neil Diamond, but surprisingly few movie celebrities; Michael Moore was an exception. Plenty of academics were proposed, notably Noam Chomsky, Albert Einstein, Martin Heidegger, Jacques Derrida, William Shockley, Paul Ehrlich and Hugh Trevor-Roper (Lord Dacre). The editor and staff of *The Economist* were also nominated several times, and many readers put their own names forward. Almost as many suggested their dogs. Anna Delprat, a 13-year-old in Sydney, nominated her father, the leader of a local micro-secession.

Among the most promising candidates were Saddam Hussein, Tony Benn, Prince Charles and Fidel Castro, who all seem to be both wise and ineffably foolish. The winning entrants, however, nominated, in equal third place, Ronald Reagan and Pope John Paul II; in second place, Yasser Arafat; and in first place, Yogi Berra. A King James version of the Bible goes to each winner.

Piers Allen of Malta nominated Ronald Reagan:

> A joke-cracking, afternoon-napping, intellectual lightweight whose memory could, in times of crisis, always be relied upon, but only to fail. Although foolish enough to announce, live on radio, that he would be bombing Russia “in five minutes” and take advice from his wife's astrologer, he was also wise enough to have survived union leadership and two terms as governor of California to reach the presidency of the United States and end the cold war favourably for the West. Any other wise fools making it to the White House will be hard pressed to fill his cowboy boots.

Barry Cornell of Sevenoaks, Kent, wrote:

> My nomination is the person who has, through his cunning, played a major role in the defeat of communism, and through his idiocy helped consign the third world to a poverty induced largely by his opposition to birth control. Step forward that almost medieval manifestation of Christendom, His Holiness the Pope.

Richard Spencer (address not supplied) chose Yasser Arafat:

> Arafat's foolishness was in “never missing an opportunity to miss an opportunity”, to quote Abba Eban. While appearing to his people as a strong leader who could stand up to the Israelis, Arafat was unable to (or simply chose not to) seize the historical moment and forge a compromise solution that would benefit the lot of the Palestinians. Had he been wise enough to make a deal with Israel when the going was good, he likely would have been buried as a bona fide world leader in a sovereign state of Palestine.

Denis Papathanasiou of Hoboken, New Jersey, nominated Lawrence Peter “Yogi” Berra, baseball player for the New York Yankees, 1946-63:

> Mr Berra hardly qualifies as an intellectual: he is famous for such remarks as “You don't look so hot yourself” (in response to a comment that he looked cool in his summer suit), “What? You mean right now?” (when asked for the time of day), and “I take a two-hour nap, from one o'clock to four.” On second glance, however, his utterances depict a certain honest Zen-like wisdom: “If you don't know where you're going, you'll wind up somewhere else,”“It was hard to have a conversation with anyone—there were so many people talking.” Those qualities have inspired a miniature popular cult of books and seminars. Not bad for a humble baseball player of modest education.

Mr Papathanasiou takes first prize.

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Obituary

Walter Wriston

Jan 27th 2005
From The Economist print edition

James Porto-Kpix

Walter Wriston, a banking visionary, died on January 19th, aged 85

WHEN Walter Wriston joined National City Bank in 1946, the industry seemed to be in a genteel decline. America's big banks were still traumatised by the Depression, the shame of massive, industry-wide scandals, and war. Some of the worst abuses stemmed from the aggressive sale of worthless securities by National City itself. Hiring had been frozen for years. Rates paid to depositors were capped, and rates paid by borrowers were, in effect, capped too. The price of a bank's shares was tied to its book value. Mr Wriston doubted he would last a year before going back to an interrupted career in the foreign service.

Instead, he not only became head of what is now known as Citigroup, but he re-imagined it and then transformed it. Mr Wriston wanted his bank to be judged on earnings, and the earnings to grow at the rate of any other top-notch business. He set a target of 15% a year, but the point was not the number—it was that he was willing to commit himself to any number, and think of a bank as a dynamic organisation.

To achieve those returns, and not to explode in the process, was quite a trick. Adding to the drama was Mr Wriston's willingness to lay out his ideas publicly in interviews and speeches. Banking, he believed, was a series of ideas that could be argued out—most immediately with regulators, but with everyone else as well.

It was all most unbankerly. But as the child of an iconoclastic president of Brown University, Mr Wriston had been brought up in the company of national and international leaders and encouraged to think boldly. His rise at National City Bank began when he was assigned the account of a Greek businessman, Aristotle Onassis, whom many believed to be mad. Onassis was clever enough to

see the post-war boom in shipping; Mr Wriston was open enough to believe that Onassis should be financed, not on asset value, but on the ability of his assets to generate cash in future. Together, the two developed financing techniques that would be used for everything from aircraft to skyscrapers.

In short succession, Mr Wriston either created or pushed through many of the innovations that would come to define a giant bank. To circumvent the limits on Citi's ability to raise funds, he promoted in the 1960s the introduction of certificates of deposit, which provided an extra dollop of fees for big depositors—in other words, corporations. In the 1970s, he led the movement to end federal constraints on how much banks could offer individual depositors. This opened up Citi's access to money. He willingly lost billions of dollars in start-up costs for credit-card and ATM machines, and was faulted for encouraging individual debt and soulless service; but these inventions proved to be the future of retail banking.

“Countries do not go bankrupt”

Abroad, he reconstructed Citi's vast international network, gutted by the war and the Depression. It was here that his greatest mistake occurred: his infamous remark that countries, unlike companies, do not go bust. This was patently untrue, as Citi's own history had demonstrated. Problems in Latin America had shaken the bank in 1907 and almost brought it down in 1919. Bonds issued for Peru, Bolivia and Chile in the 1920s had defaulted in the 1930s. Citi's branches were nationalised by Russia, Egypt, China and Cuba—suggesting that even when governments are solvent, they can be toxic for banks.

Close colleagues stressed that Mr Wriston did not really mean what he said. He meant that countries could not be obliterated; if they went bust, their economies could be reorganised, and it was not the end of the world. Certainly it was not the end for Citi, which survived the emerging-market debt crises of the 1980s on the profits of the retail franchise that Mr Wriston had created. Nor did he believe in government bail-outs for his emerging-markets loans or any other part of the financial market—not in the 1980s, or in the late 1990s. Collapses, he believed, were an inevitable part of a dynamic market.

His approach to managing was equally Darwinian. He tried to hire the brightest people from a wide range of backgrounds, allowed them to compete, gave them their heads and judged them on merit. It was exhilarating and dynamic, and also vicious and explosive.

He himself was not without contradictions. In 1970, he lobbied for a bail-out of Citi for its exposure to the bankruptcy of the Penn Central Railroad. His love of technology did not necessarily lead to efficient internal systems. Many employees loved him for being playful and unpretentious: a visitor to his office might find him playing with a yo-yo at his desk. But his own authority was absolute. He orchestrated a multi-year succession battle, and no one knew who had won until Mr Wriston left the building in 1984.

His book on information technology, “The Twilight of Sovereignty” (1992), was as good a description of the impact of what became known as the internet as anything written since. As a banker and a thinker, he valued what his competitors considered transitory—information and understanding—over what he himself considered transitory, position or assets. He thought no subject was more important, and he was probably right.

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Overview

Jan 27th 2005
From The Economist print edition

The **dollar** continued its recent rally, rising to a two-month high against the euro despite reports that many central banks have been favouring the latter.

According to a survey by the Conference Board, **American consumer confidence** rose in January. Improving labour-market conditions helped raise the survey's index of consumer sentiment to 103.4 in January from 102.7 in December.

Sales of **existing homes** in America fell in December to an annual pace of 6.69m, down from November's rate of 6.92m.

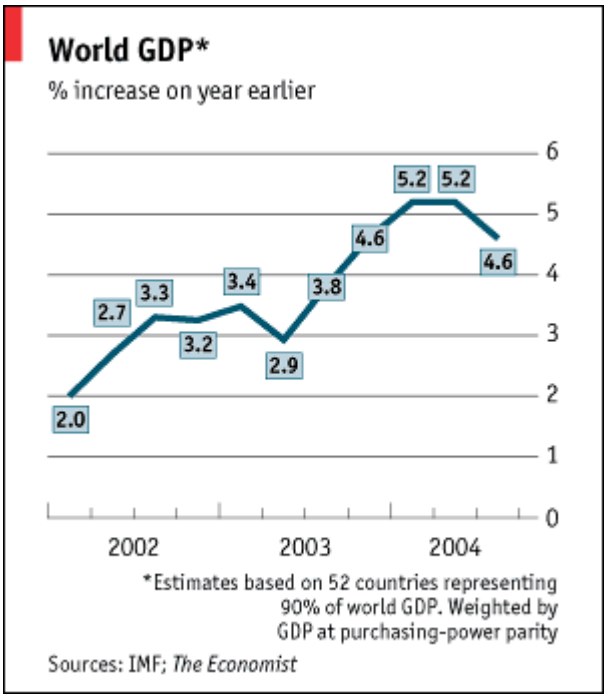
According to EuroCOIN, a composite economic indicator published by Britain's Centre for Economic Policy Research, **euro-area economic growth** slowed further in December. Although surveys of purchasing managers indicated expansion, other components of the indicator, such as industrial production, registered a slowdown.

In January, **Germany's** Ifo index of business confidence rose to its highest level in 11 months.

Thanks partly to strong demand from pension funds, yields on **30-year German government bonds** fell to 4.007%, a record low, before rebounding to 4.03%.

Britain's economy grew by 2.8% in the year to the fourth quarter, compared with growth of 3.2% in the year to the third quarter. However, manufacturing activity contracted.

Consumer prices in **Australia** rose by 2.6% in the year to the fourth quarter, compared with a rise of 2.3% in the year to the third quarter.



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Output, demand and jobs

Jan 27th 2005
From The Economist print edition

% change on year ago

	GDP latest		GDP qtr*	The Economist poll GDP forecasts 2004	2005	Industrial production latest		Retail sales (volume) latest		Unemployment % rate latest		year ago
Australia	+ 3.0	Q3	+ 1.2	+ 3.6	+ 3.0	+ 4.2	Q3	+ 5.7	Q3	5.1	Dec	5.8
Austria	+ 2.7	Q3	+ 3.2	+ 1.7	+ 2.1	+ 7.4	Oct	– 2.9	Oct	4.5	Dec	4.6
Belgium	+ 2.9	Q3	+ 3.2	+ 2.5	+ 2.1	+ 3.0	Nov	– 0.8	Oct	12.8	Dec†	12.7
Britain	+ 2.8	Q4	+ 3.0	+ 3.2	+ 2.4	– 0.9	Nov	+ 3.2	Dec	4.7	Nov††	4.9
Canada	+ 3.3	Q3	+ 3.2	+ 2.8	+ 3.1	+ 3.6	Oct	+ 5.0	Oct	7.0	Dec	7.4
Denmark	+ 1.8	Q3	+ 0.5	+ 2.1	+ 2.0	– 1.6	Nov	+ 8.5	Nov	6.2	Dec	6.7
France	+ 1.9	Q3	– 0.1	+ 2.1	+ 1.8	+ 2.1	Nov	+ 3.5	Nov	9.9	Nov	9.9
Germany	+ 1.3	Q3	+ 0.4	+ 1.3	+ 1.2	– 0.2	Nov	+ 0.1	Nov	10.8	Dec§	10.5
Italy	+ 1.3	Q3	+ 1.7	+ 1.2	+ 1.5	– 2.8	Nov	– 3.5	Oct	7.7	Jun	8.6
Japan	+ 2.6	Q3	+ 0.2	+ 3.2	+ 1.6	+ 4.5	Nov	+ 0.3	Nov	4.5	Nov	5.1
Netherlands	+ 1.5	Q3	+ 1.3	+ 1.2	+ 1.2	– 0.7	Nov	– 2.6	Oct	6.5	Dec**	5.7
Spain	+ 2.6	Q3	+ 2.4	+ 2.6	+ 2.4	+ 4.0	Nov	+ 3.2	Nov	10.5	Nov	11.2
Sweden	+ 3.9	Q3	+ 3.8	+ 3.4	+ 2.8	+ 1.2	Nov	+ 7.7	Nov	5.6	Dec†	5.1
Switzerland	+ 1.8	Q3	+ 1.4	+ 1.8	+ 1.8	+ 3.5	Q3	+ 3.9	Nov	4.0	Dec†	4.1
United States	+ 4.0	Q3	+ 4.0	+ 4.4	+ 3.5	+ 4.4	Dec	+ 4.3	Nov	5.4	Dec	5.7
Euro area	+ 1.8	Q3	+ 1.1	+ 1.8	+ 1.6	+ 0.5	Nov	+ 0.4	Nov	8.9	Nov	8.9
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 3.2	Q3	+ 4.3	na	na	+ 3.1	Nov	+ 4.0	Nov	7.7	Dec†	8.2
Greece	+ 3.8	Q3	na	na	na	+ 2.8	Nov	+ 6.3	Oct	10.7	Mar	9.8
Iceland	+ 7.4	Q3	na	na	na	na		na		2.7	Dec†	3.4
Ireland	+ 5.8	Q3	na	na	na	–10.4	Nov	+ 4.2	Nov	4.2	Dec	4.4
Luxembourg	+ 2.1	2003	na	na	na	+ 5.2	Oct	+ 5.4	Nov	4.5	Nov	4.1
New Zealand	+ 4.0	Q3	+ 1.9	na	na	+ 4.5	Q3	+ 7.4	Q3	3.8	Q3	4.4
Norway	+ 1.8	Q3	– 3.9	na	na	+ 0.9	Nov	+ 3.3	Nov	3.6	Dec†	3.9
Portugal	+ 0.8	Q3	– 4.9	na	na	– 3.8	Nov	+ 4.4	Oct	6.8	Q3†	6.1

*% change on previous quarter at an annual rate. †Not seasonally adjusted. ††Sep-Nov; claimant count rate 2.7% in Dec.
§EU harmonised rate 10.0% in Dec. **Oct-Dec.

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Prices and wages

Jan 27th 2005
From The Economist print edition

% change on year ago

	Consumer prices latest		Consumer prices year ago	The Economist poll consumer prices forecast 2004	The Economist poll consumer prices forecast 2005	Producer prices latest		Producer prices year ago	Wages/earnings latest		Wages/earnings year ago
Australia	+ 2.6	Q4	+ 2.4	+ 2.3	+ 2.5	+ 8.2	Q4	– 1.1	+ 3.7	Q3	+ 5.1
Austria	+ 2.9	Dec	+ 1.2	+ 2.0	+ 1.7	+ 5.2	Dec	+ 2.5	+ 2.0	Dec	+ 2.3
Belgium	+ 2.3	Dec	+ 1.7	+ 2.1	+ 1.7	+ 5.6	Nov	– 0.3	+ 2.4	Oct	+ 1.8
Britain	+ 1.6	Dec*	+ 1.3	+ 1.5	+ 1.7	+ 2.9	Dec	+ 1.8	+ 4.2	Nov†	+ 3.6
Canada	+ 2.1	Dec	+ 2.0	+ 1.9	+ 2.1	+ 4.1	Nov	– 4.1	+ 2.3	Oct	+ 3.2
Denmark	+ 1.2	Dec	+ 1.4	+ 1.2	+ 1.6	+ 2.7	Dec	+ 0.2	+ 2.9	Q3	+ 3.7
France	+ 2.1	Dec	+ 2.2	+ 2.2	+ 1.6	+ 3.1	Nov	+ 0.8	+ 2.7	Q3	+ 2.9
Germany	+ 2.1	Dec	+ 1.1	+ 1.8	+ 1.3	+ 3.8	Dec	+ 1.2	+ 0.3	Nov	+ 0.6
Italy	+ 2.0	Dec	+ 2.5	+ 2.3	+ 2.0	+ 4.2	Nov	+ 1.2	+ 2.7	Nov	+ 2.5
Japan	+ 0.8	Nov	– 0.5	– 0.1	nil	+ 1.9	Dec	– 0.2	+ 3.6	Nov	+ 0.1
Netherlands	+ 1.2	Dec	+ 1.7	+ 1.3	+ 1.2	+ 5.6	Nov	+ 1.1	+ 0.9	Dec	+ 2.4
Spain	+ 3.2	Dec	+ 2.6	+ 3.0	+ 2.8	+ 5.0	Dec	+ 1.1	+ 2.2	Q3	+ 3.1
Sweden	+ 0.4	Dec	+ 1.4	+ 0.7	+ 1.5	+ 2.9	Nov	– 1.6	+ 3.7	Oct	+ 3.2
Switzerland	+ 1.3	Dec	+ 0.6	+ 0.8	+ 1.2	+ 1.5	Dec	– 0.2	+ 1.4	2003	+ 1.8
United States	+ 3.3	Dec	+ 1.9	+ 2.7	+ 2.4	+ 4.1	Dec	+ 3.7	+ 2.7	Dec	+ 1.8
Euro area	+ 2.4	Dec	+ 2.0	+ 2.1	+ 1.8	+ 3.6	Nov	+ 1.4	+ 2.0	Q3	+ 2.8
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 0.4	Dec	+ 0.6	na	na	+ 0.7	Dec	– 0.4	+ 3.1	Q3	+ 4.3
Greece	+ 3.1	Dec	+ 3.1	na	na	+ 2.6	Nov	+ 2.6	na		na
Iceland	+ 4.0	Jan	+ 2.4	na	na	+ 8.6	Jan	+ 1.3	+ 6.0	Dec	+ 5.4
Ireland	+ 2.6	Dec	+ 1.9	na	na	– 1.6	Nov	– 8.4	+ 4.5	Q3	+ 4.6
Luxembourg	+ 2.2	Dec	+ 2.1	na	na	+15.7	Nov	+ 1.1	– 2.5	Oct	na
New Zealand	+ 2.7	Q4	+ 1.6	na	na	+ 2.5	Q3	+ 0.1	+ 2.2	Q3	+ 2.3
Norway	+ 1.1	Dec	+ 0.6	na	na	+ 9.7	Dec	+ 0.7	+ 4.6	Q3	+ 4.2
Portugal	+ 2.5	Dec	+ 2.4	na	na	+ 4.7	Dec	nil	+ 2.2	Nov	– 1.6

*RPI inflation rate 3.5% in Dec. †Sep-Nov.

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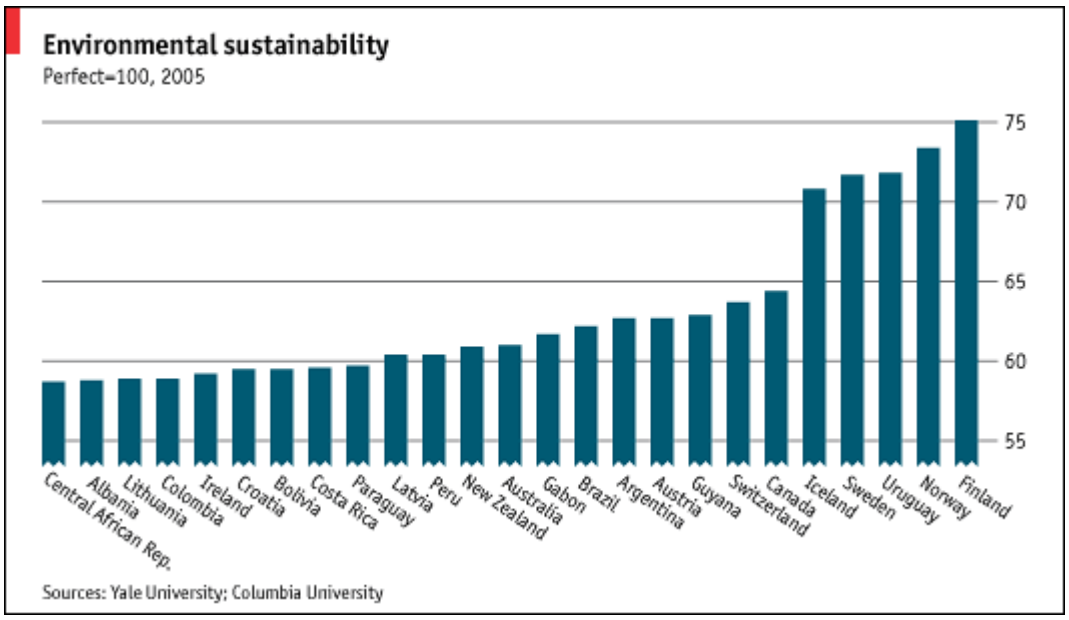
Environmental sustainability

Jan 27th 2005
From The Economist print edition



Finland, Norway and Uruguay have the most environmentally sustainable economies, according to a study by two American universities, Yale and Columbia. Their Environmental Sustainability Index ranks 146 countries by their ability to protect the environment over the next few decades, based on indicators for such things as population density, quality of governance and economic health.

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Money and interest rates

Jan 27th 2005
From The Economist print edition

	Money supply* % change on year ago			Interest rates % a year (Jan 26th 2005)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	+ 3.3	+ 9.9	Nov	5.41	5.57	5.15	5.35	5.72	6.24
Britain	+ 5.8	+11.4	Dec	4.81	4.06	4.48	4.59	4.79	5.24
Canada	+12.1	+ 9.9	Nov	2.43	2.24	2.82	4.29	4.63	5.65
Denmark	+12.0	+12.5	Nov	2.25	2.15	2.42	3.66	4.26	5.01
Japan	+ 4.1	+ 2.0	Dec	0.02	0.03	0.10	1.34	1.32	1.43
Sweden	+ 2.2	+ 4.9	Nov	1.98	2.55	2.17	3.65	4.56	2.20
Switzerland	– 5.3	+ 1.2	Dec	0.75	0.24	0.82	2.12	2.56	2.22
United States	+ 5.4	+ 6.2	Dec	2.56	1.00	3.26	4.19	4.19	5.44
Euro area†	+ 9.7	+ 6.0	Nov	2.14	2.08	2.39	3.53	4.10	3.76

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. †Germany for bonds. Benchmarks: US 30-year 4.66%, Japan No. 266 1.34%. Central bank rates: US fed funds 2.25%, ECB refinancing 2.00%, BOJ overnight call 0.001%, BOE repo 4.75%. Sources: Commerzbank, Danske Bank, J.P. Morgan Chase, Royal Bank of Canada, Stockholmsbörsen, UBS, Global Insight, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

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The Economist commodity price index

Jan 27th 2005
From The Economist print edition

1995=100

	Jan 18th	Jan 25th*	% change on one month	% change on one year
Dollar index				
All items	89.6	90.0	– 0.6	– 2.9
Food	82.6	82.7	– 0.5	– 9.1
Industrials				
All	99.1	99.9	– 0.6	+ 5.1
Nfa†	83.7	84.9	+ 2.3	– 9.0
Metals	112.1	112.7	– 2.4	+16.6
Sterling index				
All items	75.7	76.2	+ 2.9	– 5.2
Euro index				
All items	90.5	91.4	+ 4.4	– 5.5
Yen index				
All items	97.8	99.7	+ 0.2	– 4.3
Gold				
$ per oz	423.15	423.50	– 4.5	+ 3.2
West Texas Intermediate				
$ per barrel	48.32	49.64	+18.6	+45.8

* Provisional. † Non-food agriculturals.

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Stockmarkets

Jan 27th 2005
From The Economist print edition

Market indices

	Jan 26th	2004-05 high	2004-05 low	% change on one week	% change on record high	% change on Dec 31st 2003 in local currency	% change on Dec 31st 2003 in $ terms
Australia (All Ordinaries)	4,056.4§	4,079.0	3,274.9	nil	– 0.6	+22.7	+26.1
Austria (ATX)	2,486.5	2,486.5	1,568.9	+ 2.0	nil	+60.9	+66.8
Belgium (Bel 20)	3,008.6	3,008.6	2,244.2	+ 1.4	–18.3	+34.1	+38.9
Britain (FTSE 100)	4,847.1	4,854.1	4,287.0	+ 0.6	–30.1	+ 8.3	+13.8
Canada (Toronto Composite)	9,162.4	9,287.4	8,123.5	+ 0.5	–19.5	+11.5	+17.2
Denmark (KBX)	260.4	261.7	219.0	– 0.3	–13.7	+21.9	+26.4
France (SBF 250)	2,683.4	2,683.4	2,386.1	+ 0.4	–38.9	+11.3	+15.3
(CAC 40)	3,879.8	3,882.0	3,465.3	+ 0.3	–44.0	+ 9.0	+13.0
Germany (DAX)	4,214.1	4,316.4	3,647.0	– 0.7	–47.7	+ 6.3	+10.1
Italy (BCI)	1,505.1	1,504.8	1,239.5	+ 0.1	–31.0	+19.8	+24.1
Japan (Nikkei 225)	11,376.6	12,163.9	10,365.4	– 0.3	–70.8	+ 6.6	+11.0
(Topix)	1,144.9	1,217.9	1,022.6	+ 0.1	–60.3	+ 9.7	+14.3
Netherlands (AEX)	356.5	364.8	310.7	+ 0.7	–49.2	+ 5.6	+ 9.4
Spain (Madrid SE)	966.4	968.0	804.4	– 0.2	–15.7	+19.6	+24.0
Sweden (Affarsvarlden Gen)	221.7	225.8	188.5	– 0.9	–44.6	+17.7	+21.9
Switzerland (Swiss Market)	5,768.4	5,934.4	5,309.7	+ 0.3	–31.4	+ 5.1	+ 9.8
United States (DJIA)	10,498.6	10,854.5	9,750.0	– 0.4	–10.4	+ 0.4	+ 0.4
(S&P 500)	1,174.1	1,213.6	1,063.2	– 0.9	–23.1	+ 5.6	+ 5.6
(NASDAQ Comp)	2,046.1	2,178.3	1,752.5	– 1.3	–59.5	+ 2.1	+ 2.1
Europe (FTSE Eurotop 300)*	1,054.8	1,056.5	940.9	+ 0.1	–38.1	+10.1	+14.1
Euro area (FTSE Ebloc 100)*	904.2	910.3	787.2	– 0.1	–41.7	+ 8.7	+12.7
World (MSCI)†	1,138.0	1,170.0	997.0	– 0.3	–21.5	+ 9.8	+ 9.8
World bond market (Citigroup)‡	657.6	666.7	575.1	nil	– 1.4	+ 8.9	+ 8.9

*In euro terms. †Morgan Stanley Capital International index includes individual markets listed above plus eight others, in $ terms.
‡Citigroup World Government Bond Index, total return, in $ terms. §Jan 25th.

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Trade, exchange rates and budgets

Jan 27th 2005
From The Economist print edition

	Trade balance*, $bn latest 12 months		Current-account balance $bn latest 12 mths		The Economist poll % of GDP, forecast 2004	2005	Exchange rate trade-weighted† 1990=100 Jan 26th	year ago	Currency units per $ Jan 26th	year ago	per £	per euro	per ¥100	Budget balance % of GDP 2004‡
Australia	− 18.0	Nov	− 36.2	Q3	− 6.0	− 5.4	87.2	89.8	1.29	1.29	2.43	1.69	1.26	+ 0.7
Austria	+ 0.5	Nov	− 1.8	Nov	− 0.6	− 0.7	103.4§	102.8	0.76	0.79	1.44	–	0.74	− 1.5
Belgium	+ 21.4	Nov	+ 11.7	Sep	+ 3.6	+ 3.4	104.0§	102.9	0.76	0.79	1.44	–	0.74	− 0.1
Britain	−104.0	Nov	− 47.4	Q3	− 2.4	− 2.6	102.5	103.0	0.53	0.55	–	0.69	0.52	− 3.2
Canada	+ 52.8	Nov	+ 26.7	Q3	+ 2.8	+ 2.2	92.9	86.7	1.23	1.32	2.31	1.61	1.19	+ 1.1
Denmark	+ 9.5	Nov	+ 5.9	Nov	+ 2.9	+ 2.6	107.1	107.0	5.69	5.92	10.7	7.44	5.53	+ 0.9
France	− 6.0	Nov	− 3.4	Nov	+ 0.1	+ 0.1	107.6§	106.3	0.76	0.79	1.44	–	0.74	− 3.7
Germany	+192.7	Nov	+ 95.9	Nov	+ 3.1	+ 2.9	105.4§	103.9	0.76	0.79	1.44	–	0.74	− 3.9
Italy	+ 0.3	Nov	− 11.8	Oct	− 0.8	− 0.9	76.7§	75.8	0.76	0.79	1.44	–	0.74	− 2.9
Japan	+131.7	Nov	+167.7	Nov	+ 3.3	+ 3.4	138.8	137.8	103	106	194	134	–	− 6.5
Netherlands	+ 36.6	Nov	+ 21.0	Q3	+ 3.0	+ 3.0	103.6§	102.3	0.76	0.79	1.44	–	0.74	− 2.9
Spain	− 72.5	Nov	− 43.3	Oct	− 3.7	− 3.9	77.8§	77.0	0.76	0.79	1.44	–	0.74	− 1.1
Sweden	+ 22.9	Dec	+ 26.2	Q3	+ 7.6	+ 6.7	82.7	81.9	6.94	7.26	13.1	9.08	6.75	+ 0.5
Switzerland	+ 8.1	Nov	+ 44.7	Q3	+12.4	+11.9	113.1	111.0	1.18	1.25	2.23	1.55	1.15	− 1.6
United States	−653.8	Nov	−603.2	Q3	− 5.5	− 5.6	90.6	94.6	–	–	1.88	1.31	0.97	− 4.4
Euro area	+ 93.9	Nov	+ 48.3	Nov	+ 0.5	+ 0.5	93.1	92.1	0.76	0.79	1.44	–	0.74	− 2.9
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*													
Finland	+ 12.8	Nov	+ 6.9	Nov	na	na	82.7§	81.6	0.76	0.79	1.44	–	0.74	+ 2.3
Greece	− 31.2	Nov	− 10.0	Nov	na	na	60.0§	59.4	0.76	0.79	1.44	–	0.74	− 5.3
Iceland	− 0.8	Nov	− 0.6	Q3	na	na	96.1**	93.0	62.4	69.0	117	81.6	60.6	+ 0.1
Ireland	+ 41.5	Oct	− 1.6	Q3	na	na	96.3§	94.5	0.76	0.79	1.44	–	0.74	+ 0.2
Luxembourg	− 4.4	Oct	+ 2.3	Q3	na	na	104.0§	102.9	0.76	0.79	1.44	–	0.74	− 0.4
New Zealand	− 2.8	Nov	− 5.3	Q3	na	na	108.8	104.6	1.39	1.49	2.62	1.82	1.35	+ 2.9
Norway	+ 34.0	Dec	+ 33.8	Nov	na	na	98.3	92.9	6.32	6.92	11.9	8.26	6.14	+ 8.2
Portugal	− 17.9	Oct	− 12.6	Nov	na	na	93.7**	93.2	0.76	0.79	1.44	–	0.74	− 2.9

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †Bank of England except §IMF, November average. ‡OECD estimate.
**IMF, September average.

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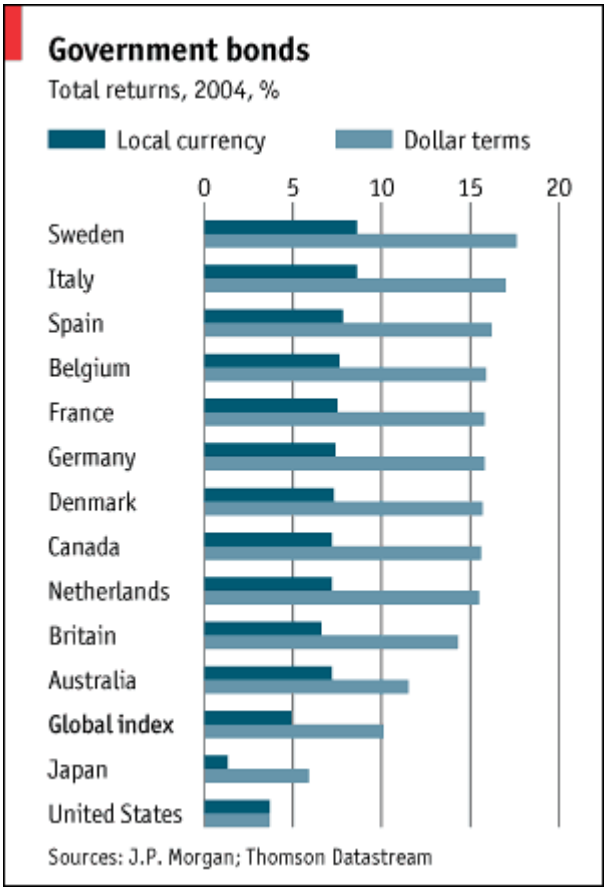
Government bonds

Jan 27th 2005
From The Economist print edition



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Overview

Jan 27th 2005
From The Economist print edition

China's economy continues to roar. GDP rose in the year to the fourth quarter by a faster-than-expected 9.5%, compared with a rise of 9.1% in the year to the third quarter. Industrial-production growth slowed slightly to 14.4% in the year to December from 14.8% in the year to November. Consumer-price inflation eased to 2.4% over the 12 months to December.

Also in the year to December, industrial production rose by 4.8% in **Russia** and by 6.4% in **Poland**.

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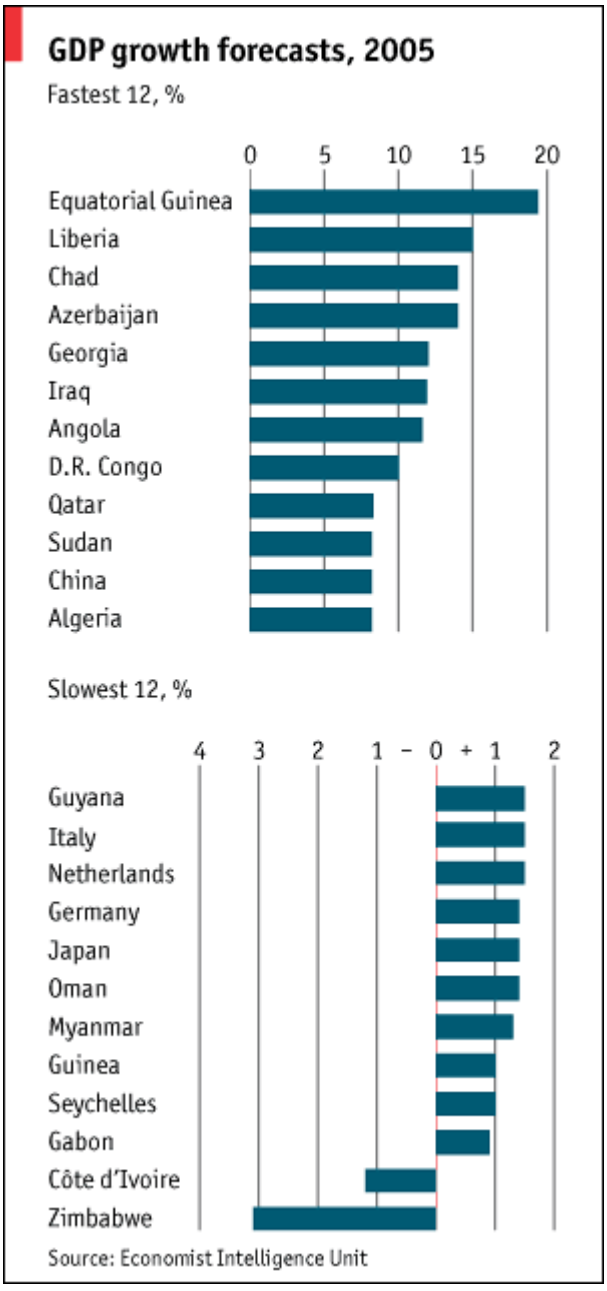
GDP growth forecasts, 2005

Jan 27th 2005
From The Economist print edition

Africa is likely to be the home both of many of the world's fastest- and of its slowest-growing economies in 2005, according to the Economist Intelligence Unit, a sister company of *The Economist*. Thanks to booming oil production, Equatorial Guinea's economy is tipped to outpace all others this year with a growth rate of 19.4%. Some of the world's biggest economies, however, are expected to struggle. Italy and the Netherlands are expected to grow by only 1.5%; Japan and Germany by 1.4%. Zimbabwe is likely to remain at the bottom of the league table, with an outright decline in output of 3.1%.



Economy

Jan 27th 2005
From The Economist print edition

	% change on year ago						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+ 9.5	Q4	+14.4	Dec	+ 2.4	Dec	+31.9	Dec	+45.9	2003	609.9	Dec
Hong Kong	+ 7.2	Q3	+ 3.4	Q3	+ 0.2	Dec	−12.4	Nov	+14.2	Q3	123.6	Dec
India	+ 6.6	Q3	+ 7.9	Nov	+ 4.2	Nov	−22.2	Dec	+ 3.5	Q3	125.2	Dec
Indonesia	+ 5.0	Q3	− 2.3	Aug	+ 6.4	Dec	+24.3	Nov	+ 4.0	Q3	34.6	Nov
Malaysia	+ 6.8	Q3	+ 9.9	Nov	+ 2.1	Dec	+21.2	Nov	+14.7	Q3	62.2	Nov
Philippines	+ 6.3	Q3	+ 8.7	Nov	+ 7.9	Dec	− 0.8	Nov	+ 4.4	Sep	12.9	Dec
Singapore	+ 5.4	Q4	+31.7	Dec	+ 1.5	Dec	+15.8	Dec	+29.0	Q3	112.8	Dec
South Korea	+ 4.6	Q3	+10.1	Nov	+ 3.0	Dec	+29.8	Dec	+27.5	Nov	192.5	Nov
Taiwan	+ 5.3	Q3	− 0.9	Dec	+ 1.6	Dec	+ 6.1	Dec	+24.8	Q3	241.7	Dec
Thailand	+ 6.0	Q3	+ 9.5	Nov	+ 2.9	Dec	+ 1.3	Nov	+ 7.0	Nov	47.1	Nov
Argentina	+ 8.3	Q3	+ 5.4	Nov	+ 6.1	Dec	+12.2	Nov	+ 3.6	Q3	19.6	Dec
Brazil	+ 6.1	Q3	+ 8.1	Nov	+ 7.6	Dec	+33.7	Dec	+10.7	Nov	50.1	Nov
Chile	+ 6.8	Q3	+ 9.9	Nov	+ 2.4	Dec	+ 8.9	Dec	+ 2.0	Q3	16.0	Dec
Colombia	+ 2.4	Q3	+ 1.4	Oct	+ 5.5	Dec	+ 0.9	Oct	− 1.4	Q3	12.2	Dec
Mexico	+ 4.4	Q3	+ 5.4	Nov	+ 5.2	Dec	− 8.1	Dec	− 5.5	Q3	63.7	Nov
Peru	+ 8.4	Nov	+ 6.1	Oct	+ 3.5	Dec	+ 2.5	Nov	− 0.3	Q3	11.5	Nov
Venezuela	+15.8	Q3	+14.7	Oct	+19.2	Dec	+21.5	Q3	+14.4	Q3	17.2	Oct
Egypt	+ 4.3	2004†	+ 3.3	2004‡	+11.9	Sep	− 8.1	Q3	+ 4.1	Q3	13.5	Sep
Israel	+ 3.4	Q3	+13.7	Nov	+ 1.2	Dec	− 6.8	Dec	+ 0.5	Q3	27.0	Dec
South Africa	+ 3.8	Q3	+ 2.3	Nov	+ 3.4	Dec	− 1.5	Nov	− 4.7	Q3	13.2	Dec
Turkey	+ 4.5	Q3	+ 9.6	Nov	+ 9.3	Dec	−34.2	Nov	−15.7	Nov	35.3	Nov
Czech Republic	+ 3.6	Q3	+10.9	Nov	+ 2.8	Dec	− 1.2	Nov	− 6.4	Q3	28.5	Dec
Hungary	+ 3.7	Q3	+ 7.9	Nov	+ 5.5	Dec	− 2.5	Q3	− 8.6	Q3	15.2	Nov
Poland	+ 4.8	Q3	+ 6.4	Dec	+ 4.4	Dec	− 5.6	Oct	− 4.3	Nov	35.8	Nov
Russia	+ 6.4	Q3	+ 4.8	Dec	+11.7	Dec	+84.6	Nov	+49.5	Q3	120.8	Dec
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Estonia	+ 6.1	Q3	+ 4.5	Nov	+ 5.0	Dec	− 2.7	Nov	− 1.5	Q3	1.6	Nov
Latvia	+ 9.1	Q3	+ 6.0	Nov	+ 7.3	Dec	− 2.7	Nov	− 1.7	Nov	1.8	Nov
Lithuania	+ 5.8	Q3	na		+ 2.9	Dec	− 3.2	Nov	− 2.0	Q3	3.6	Nov
Slovakia	+ 5.3	Q3	+ 2.5	Nov	+ 5.9	Dec	− 1.2	Nov	− 0.9	Sep	13.4	Nov
Slovenia	+ 4.9	Q3	+ 3.8	Nov	+ 3.2	Dec	− 1.5	Nov	− 0.1	Nov	8.2	Oct
Pakistan	+ 6.4	2004†	+18.6	Jul	+ 7.4	Dec	− 5.0	Dec	+ 0.8	Q3	9.8	Dec
Saudi Arabia	+ 7.2	2003	na		+ 0.4	Oct	+59.1	2003	+28.0	2003	23.6	Nov

*Excluding gold, except Singapore; IMF definition. †Year ending June. ‡Year ending June, new series.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank

Financial markets

Jan 27th 2005
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Jan 26th		Dec 31st 2003	
	Jan 26th	year ago	Jan 26th	% a year		one week	in local currency	in $ terms
China	8.28	8.28	15.6	2.50	1,303.8	+2.0	– 16.9	– 16.9
Hong Kong	7.80	7.77	14.7	0.85	13,623.7	–0.4	+ 8.3	+ 7.8
India	43.7	45.3	82.2	5.39	6,163.0††	–0.2	+ 5.5	+ 10.3
Indonesia	9,142	8,418	17,201	7.56	1,037.5	+0.9	+ 50.0	+ 38.2
Malaysia	3.80	3.80	7.15	2.82	923.4	–1.3	+ 16.3	+ 16.3
Philippines	55.3	55.9	104.1	7.00	1,970.3	+1.2	+ 36.6	+ 37.1
Singapore	1.63	1.69	3.07	1.75	2,086.9	–0.5	+ 18.3	+ 23.1
South Korea	1,032	1,172	1,941	3.53	927.0	+1.2	+ 14.3	+ 32.1
Taiwan	31.8	33.3	59.7	1.35	5,835.4	–1.0	– 0.9	+ 5.9
Thailand	38.5	39.0	72.4	2.45	702.7	–0.9	– 9.0	– 6.3
Argentina	2.92	2.92	5.50	4.38	1,355.3	+1.4	+ 26.4	+ 26.9
Brazil	2.67	2.88	5.02	18.24	24,530.2	+1.1	+ 10.3	+ 19.2
Chile	585	584	1,100	2.76	8,754.8	+1.0	+ 19.3	+ 21.0
Colombia	2,371	2,724	4,462	7.79	4,314.2	+0.3	+ 84.9	+116.7
Mexico	11.3	10.9	21.2	8.63	13,045.1	+0.1	+ 48.3	+ 48.0
Peru	3.26	3.48	6.14	2.94	3,931.2	+2.8	+ 61.4	+ 71.4
Venezuela	2,751§	2,949§	5,176	12.59	29,224.4	–0.5	+ 31.6	+ 36.4
Egypt	5.86	6.16	11.02	9.90	28,829.8	+8.5	+147.7	+160.7
Israel	4.41	4.48	8.30	1.00	652.0	–0.1	+ 22.0	+ 21.6
South Africa	5.95	6.93	11.2	7.60	12,607.4	+0.8	+ 21.4	+ 36.2
Turkey	1.35**	1.34**	2.54	19.80	27,056.0	+0.5	+ 45.3	+ 51.9
Czech Republic	23.0	26.4	43.3	2.55	1,098.3	+3.5	+ 66.6	+ 86.0
Hungary	188	209	353	8.89	15,212.7	+0.5	+ 62.2	+ 79.4
Poland	3.11	3.78	5.85	6.64	25,582.9	+0.8	+ 22.9	+ 48.0
Russia	28.0	28.5	52.7	13.00	605.3‡	+1.0	+ 2.3	+ 6.7
EMF (MSCI)*	1.00	1.00	1.88	na	532.8	+0.7	+ 20.3	+ 20.3
EMBI+†	1.00	1.00	1.88	na	330.7	+1.1	+ 12.2	+ 12.2

*Emerging Mkts Free. †J.P. Morgan Chase's Emerging Mkts Bond Index Plus. ‡In $ terms. §Floating exchange rate. **New lira. ††Jan 25th.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank

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